Grant Thornton

Top 10 SALT stories of 2021

Contents

Last year, we noted that the most die-hard state and local tax (SALT) experts wouldn't remember the top SALT stories of 2020 because of the titanic effects of the pandemic. We began 2021 with the promise of widespread vaccines and optimism that our economy could fully reopen and our society could fully interact again. And perhaps a little healing of our body politic could occur as we "returned to normal."

Unfortunately, even before the vaccines came, just six days into the new year, our nation's capital was breached by protestors in an effort to overturn the presidential election results being certified that day. That event has resonated since, highlighting the fact that our severe political divide will not go away any time soon. And what happens in Washington doesn't stay there – as reflected below, it gets played out in every state capital in the debate on social, budgetary and SALT matters as well. It is especially apparent in the relatively few states that have divided control of the executive and legislative branches of the government. But we also see it in the states with one-party control, in which efforts to redraw political boundaries and enact legislation primarily designed to protect majorities are prevalent.

After the transition in government, and once severe short-term supply chain issues were resolved, the vaccines helped immensely in places where people were willing to take them. Again, however, due in part to the political environment, a significant minority of individuals did not get vaccinated.

This led to continued health challenges amplified by the Delta variant, and the vision of a "hot vax summer" that danced in our collective heads wasn't fully realized everywhere for very long. And now, after months of dealing with the Delta wave, the specter of the Omicron variant calls into question, how much longer? It's patently clear that as of this writing the pandemic still casts a long shadow over everything, including SALT.

So it's not surprising that many of this year's top SALT stories revolve around reactions to the pandemic, and to the increased visibility of SALT as issues play out in both the federal legislative and judicial domains. In addition, the return of regularly scheduled live legislative sessions in many state capitals that were forced to shut down in 2020 gave legislators the ability to address short-term concerns as well as long-term tax reforms.

Our Grant Thornton SALT team in the Washington National Tax Office considered what happened this year, and then ranked the 10 most important SALT stories of 2021 in order of perceived importance. As reflected below, the panoply of interlocking federal and SALT issues dominated the headlines. From the development of new tax regimes for pass-through entities in response to federal legislation, to the provision of federal funding to the states with a major string affecting SALT policy attached, and even to taxes on billboard advertising, 2021 provided many examples of how federal and SALT policies intersect.

1. SALT cap spurs PTE tax regimes

The biggest story of the 2021 state legislative sessions was the widespread adoption of pass-through entity (PTE) tax regimes as a workaround to the controversial federal $10,000 SALT deduction limitation adopted under the Tax Cuts & Jobs Act (TCJA).[1] In 2018, states first began enacting elective pass-through entity (PTE) tax regimes as a workaround to the SALT deduction cap, with Connecticut being the only state to adopt a mandatory PTE tax. Under these regimes, the PTE is permitted to deduct its state and local income taxes as a tax on the business at the federal level, followed by a deduction for the PTE tax on the distributive share of the owners' income. Depending on the structure of the PTE tax, the owner generally claims a corresponding tax credit against their personal tax liability or an exclusion on the portion of the owner's pass-through income subject to the entity tax.

Seven states had enacted PTE taxes through November 2020,[2] when the IRS confirmed that state PTE tax regimes would be respected for federal income tax purposes, therefore providing a more acceptable framework for partnerships and S corporations to deduct the tax at the entity level.[3] Since that time, states moved at a rapid pace to adopt their own elective state PTE regimes, with 14 additional states having done so in 2021 to date.[4] Notably, New York adopted a PTE tax as part of the state's 2022 fiscal year budget in April, first applicable to the 2021 tax year.[5] California soon enacted a SALT cap workaround measure in July that begins with the 2021 tax year, and Illinois followed by enacting its own PTE tax in August, also beginning with the 2021 tax year.[6] More recently, the Massachusetts legislature voted in September to approve a PTE tax regime with a 90% limitation on the credit available to PTE owners, over the objections of the Massachusetts governor, who had vetoed the measure.[7]

While the state rush to adopt PTE taxes presents advantages to PTE owners at first glance due to the federal tax benefit, the reality is that each of the tax regimes differs from each other in material ways, presenting complications for multistate PTEs deciding whether to elect into such regimes. First, states provide varying rules with respect to the timing of the election, with some states allowing entities to make the election on an originally filed or extended tax return, while others require an earlier election to be made.[8] States also differ with respect to eligible entities, with states such as Arizona, California and Minnesota disallowing elections for lower-tier PTEs that are owned by other PTEs. There are also substantial differences regarding the mechanics of each tax, from applicable tax rates to estimated payment procedures to the method of making the election. Still another important consideration is whether non-resident owners are required to file a non-resident personal tax return if their only source of income is from the electing PTE.

From a technical perspective, a common question among multistate PTEs is whether states will provide a credit to resident PTE owners against their personal income tax liability for taxes paid to other states at the entity level. There remains a significant lack of uniformity regarding this question due to the novelty of the tax regimes and the fact that over half the states do not have their own PTE tax with a similar credit mechanism. Many of these states have not yet spoken as to the applicability of a credit for taxes paid at the entity level instead of by the individual, while states including Maine have already made clear that they will not allow a credit for such taxes paid.[9] For states that have enacted their own PTE tax, some may only respect PTE tax systems in other states that are "substantially similar" to theirs, such as New York.[10] Finally, there is some uncertainty with respect to the application of the resident credit in states providing an income exclusion instead of a credit to their owners.

[1] The TCJA capped the individual SALT deduction at $10,000 for individuals and most married couples for the 2018-2025 tax years. IRC § 164(b)(6)(B).
[2] Connecticut, Louisiana, Maryland, New Jersey, Oklahoma, Rhode Island, and Wisconsin enacted PTE-level taxes through 2020.
[3] Specifically, the IRS confirmed that PTE businesses may claim an entity-level deduction for state and local income tax paid under state laws that shift the burden from individual owners to the business entity. Notice 2020-75, Forthcoming Regulations Regarding the Deductibility of Payments by Partnerships and S Corporations for Certain State and Local Income Taxes, Internal Revenue Service, Nov. 9, 2020.
[4] As of this writing, the following states enacted PTE taxes in the 2021 legislative sessions: Alabama, Arizona, Arkansas, California, Colorado, Georgia, Idaho, Illinois, Massachusetts, Minnesota, New York, North Carolina, Oregon and South Carolina.
[5] N.Y. Ch. 59 (S. 2509-C, A.3009-C), Laws 2021. For further discussion, see GT SALT Alert: New York state enacts tax increases in budget.
[6] Cal. A.B. 150, Laws 2021; Ill. S.B. 2531, Laws 2021. For further discussion of these PTE tax regimes, see GT SALT Alert: "California provides elective passthrough entity tax;" and GT SALT Alert: "Illinois enacts income and franchise tax changes."
[7] Mass. H.B. 4009, Laws 2021, enacted Sep. 30, 2021.
[8] For example, New York required PTEs to make an irrevocable election online by Oct. 15, 2021, to enter into the state's PTE tax regime in order to be effective for the 2021 tax year, and no extensions were permitted.
[9] For further discussion, see GT SALT Alert: "Maine owner of Connecticut LLC denied tax credit."
[10] N.Y. TAX LAW § 620(b).

In addition to the resident tax credit question, other technical questions can easily trip up unwary taxpayers electing into state PTE tax regimes. First, the state PTE tax base can vary widely. While most states use the PTE's federal taxable income as the starting point, New York's PTE tax base includes only the distributive shares of resident and nonresident taxpayers subject to the state's personal income tax, meaning that income distributed to corporate or other pass-through owners would be excluded. Next, states such as Massachusetts do not offer a full 100% credit to PTE owners for their share of the tax paid by the PTE, which instantly detracts from the state benefit of electing into such regimes. Beyond the state tax technical implications, there are numerous federal income tax implications that could offset the federal benefits of making the state elections depending on the facts and circumstances of each PTE.

While state PTE taxes have proven to be a popular workaround to the federal SALT deduction limitation that simultaneously do not adversely impact state tax revenues, the differing nature of each state PTE tax regime presents complications and uncertainty. PTEs are faced with making elections that will impact the tax liability of their owners, some of which may benefit more than others due to factors such as their resident state and their ownership interest in the PTE. Given the rapid adoption of state PTE taxes in 2021, impacted PTEs should undertake a holistic analysis of all regimes as applied to their entity structure to determine whether an election would be beneficial. It is also important to monitor state administrative guidance that continues to be released, given the fact that many state legislatures left it to their taxing agencies to implement specific rules for each tax. Against this complex backdrop, there remains the possibility that Congress may substantially change or increase the SALT deduction limitation applicable in 2021 as the House and Senate continue to debate a spending bill that may see passage before the end of the year.

2. States challenge ARPA tax mandate

As a means to combat the economic effects of the COVID-19 pandemic, the American Rescue Plan Act (ARPA)[11] created Coronavirus State and Local Fiscal Recovery Funds for distribution to state and local governments. Under ARPA, states are required to use the funds for either a wide variety of pandemic-related purposes, or to make necessary investments in water, sewer or broadband infrastructure.[12] Specifically, states are prohibited from using the funds to offset a reduction in state net tax revenue resulting from a change in law, regulation or administrative interpretation during a "covered period" that reduces any tax, or from depositing the funds into a pension fund.[13] In response to numerous requests by states for information on the scope of this provision, the U.S. Treasury Department adopted interim rules designed to provide further guidance to states regarding when the ARPA tax mandate would be triggered.[14] The tax mandate has led to several constitutional challenges, resulting in three significant court decisions during 2021 granting injunction against enforcement to date. Further challenges remain outstanding.[15]

First, Ohio challenged the ARPA tax mandate immediately upon its enactment, filing suit in the U.S. District Court for the Southern District of Ohio for relief.[16] The challenge was based on grounds that the tax mandate violates the Spending Clause, as well as the 10th Amendment of the U.S. Constitution.[17] Ohio challenged the ARPA tax mandate on both coercion and ambiguity grounds, but the court ultimately relied on the ambiguity in the enacting statute to determine that the mandate fell short of the clarity needed to meet the dictates of the Spending Clause. The court noted that the Constitution requires Congress to advise states of the specific conditions attached to funding, not just to advise that conditions exist. In this case, the tax mandate did not put Ohio on clear notice of its obligations. Thus, the court concluded that the ambiguously written tax mandate exceeded Congress's power under the Spending Clause and granted a permanent injunction against application of the tax mandate to Ohio, based on satisfying the relevant four-part test governing such relief.[18]

On Sept. 24, 2021, a Kentucky federal district court likewise granted Kentucky and Tennessee a permanent injunction from application of the controversial ARPA spending restriction, finding it to be a coercive grant of federal money.[19] In their filing, Kentucky and Tennessee asserted that the mandate: (i) is unconstitutionally ambiguous and coercive in violation of the Spending Clause; (ii) is not reasonably related to the federal interest in passing the ARPA; and (iii) violates the anti-commandeering doctrine. In response, the federal government asserted that Congress had not exceeded the bounds of its authority for Spending Clause purposes. In prior U.S. Supreme Court decisions addressing possible coercion, the court observed that one significant determining factor was whether the states alleging the tactic might realistically refuse to accept the money if they did not accede to the conditions.[20] In this instance, the ARPA funds represent roughly 20% of the annual state tax collections brought in by state governments.[21] Given the "choice" of whether to accept the federal ARPA funds, the court determined that under the circumstances, the jurisdictions had no voluntary or knowing choice as to whether to accept the funds. Thus, it found the tax mandate to be coercive, and as such, the condition could not be sustained. The court noted that when the federal government unduly influences the states' power to set their own tax policies, it oversteps its bounds. The court further granted a permanent injunction enjoining the Treasury Secretary from enforcing the tax mandate provision of the ARPA in Kentucky and Tennessee.

[11] P.L. 117-2 (2021).

[12] Social Security Act, Title VI, 42 U.S.C. § 802(c)(1). The "covered period" began on March 3, 2021, and ends on the last day of the fiscal year in which the funds are used or returned to the federal government. As the funds obtained from ARPA must be spent by Dec. 31, 2024, the ending date of the covered period could extend for several years. The states are required to comply with certification and reporting requirements to receive the funds, and the federal government has the right to recoup the funds if the states do not comply with the ARPA restrictions.

[13] Social Security Act, Title VI, 42 U.S.C. § 802(c)(2).

[14] 31 C.F.R. Part 35, RIN 1505-AC77, "Coronavirus State and Local Fiscal Recovery Funds."

[15] For an issue paper addressing challenges to ARPA, see Joseph Bishop-Henchman, National Taxpayers Union, "Six Lawsuits Filed to Challenge ARPA Ban on State Tax Cuts," June 3, 2021, published at: https://www.ntu.org/foundation/detail/six-lawsuits-filed-to-challenge-arpa-ban-on-state-tax-cuts#ftnt10.

[16] Ohio v. Yellen, United States District Court for the Southern District of Ohio, Western Division, Case No. 1:21-cv-18, 2021 U.S. Dist. LEXIS 123008, July 1, 2021. See GT SALT Alert: "Ohio granted injunction from ARPA tax cut provision."

[17] The Spending Clause states that "Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States . . ." U.S. CONST. art. I, § 8, cl. 1. The Tenth Amendment states that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people." U.S. CONST. amend. X.

[18] See eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388 (2006), in which the U.S. Supreme Court noted the four requirements for a plaintiff to obtain a permanent injunction: "(1) that it suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction."

[19] Commonwealth of Kentucky, et al v. Yellen, United States District Court for the Eastern District of Kentucky, Central Division, Case No. 3:21-cv-00017-GFVT-EBA, Sept. 24, 2021.

[20] See South Dakota v. Dole, 483 U.S. 203 (1987) and National Federation of Independent Business v. Sebelius, 567 U.S. 519 (2012).

[21] See Four Questions Treasury Must Answer About the State Tax Cut Prohibition in the American Rescue Plan Act, Jared Walczak, Tax Foundation (Mar. 18, 2021).

Most recently, a federal district court issued a determination in response to a similar challenge by several states, led by West Virginia.[22] Again, the court found the tax mandate violated constitutional limits by exceeding Congress' power. Specifically, the court found that the tax mandate provision dictates not just what states do with federal funds, but also with state funds, and that it restricts states' abilities to adopt their own tax policy. Therefore, it granted an injunction from enforcement in the relevant states.

With three U.S. District Court decisions finding similarly that the tax mandate provision is unconstitutional, and several additional challenges outstanding, the focus may now turn to whether, and if so, when the Treasury Secretary will provide further guidance regarding the mandate and how it will be enforced. Given the distinctive and compelling sovereignty issues raised by the ARPA tax mandate, the potential conflicting views of different circuit courts, and the effect that the mandate could have on future state taxation policies, it may only be a matter of time until the ARPA tax mandate controversies are raised before the U.S. Supreme Court.

[22] West Virginia et. al. v. U.S. Dept. of the Treasury, et. al., United States District Court for the Northern District of Alabama, Western Division, Case No. 7:21-cv-00465, Nov. 15, 2021. Additional states include Alabama, Arkansas, Alaska, Florida, Iowa, Kansas, Montana, New Hampshire, Oklahoma, South Carolina, South Dakota, and Utah. For an issue paper addressing challenges to ARPA, see Joseph Bishop-Henchman, National Taxpayers Union, "Six Lawsuits Filed to Challenge ARPA Ban on State Tax Cuts," June 3, 2021, published at: https://www.ntu.org/foundation/detail/six-lawsuits-filed-to-challenge-arpa-ban-on-state-tax-cuts#ftnt10.

3. SALT implications of COVID–19 telework

Over a year and a half into the COVID-19 pandemic, hybrid and even full-remote work arrangements have become commonplace in many industries as employees have settled into more flexible lifestyles that such arrangements often provide. For those businesses that were planning to return their employees to the workplace at some point in 2021, the Delta variant delayed those plans indefinitely for some, once again causing many employers to re-think their policies in order to facilitate long-term remote work arrangements. Continued remote work brought new state and local tax challenges for employers in 2021 as taxing authorities began rescinding temporary payroll tax withholding and nexus policies, many of which were in effect since the early days of the pandemic. As a result, businesses with growing mobile workforces were left to navigate conflicting state and local tax approaches to remote work in 2021.[23]

Early into the pandemic, many states issued temporary emergency guidance addressing the income tax treatment of employees working from a different state due to the pandemic. Most states indicated that income tax withholding requirements would not change during the time that applicable state-of-emergency declarations were in effect, or through a specific end date. Similarly, states released guidance providing for the temporary suspension of corporate income tax and/or sales tax nexus thresholds where the pandemic forced employees to work remotely in a state where the company would otherwise not have nexus. However, many states recently announced the end of temporary guidance in conjunction with the lifting of state and local public health restrictions, with many having done so during the summer and fall months of 2021.[24] A handful of states, including South Carolina and Wisconsin, extended their income tax withholding and nexus relief through Dec. 31, 2021.[25]

Taking a more aggressive approach, Massachusetts adopted a temporary emergency regulation that allowed the state to tax the income of non-resident employees who worked in the state prior to the pandemic, but who were teleworking during the pandemic.[26] In response, the border state of New Hampshire, which does not impose a personal income tax, asked the U.S. Supreme Court to rule on whether Massachusetts may constitutionally tax non-residents working in New Hampshire and lacking a connection with the taxing state during the pandemic.[27] Ultimately, the U.S. Supreme Court declined to hear the case as a matter of original jurisdiction.[28] One potential factor behind why the court may not have taken the case was the temporary nature of the Massachusetts regulation, which expired in September 2021. Nonetheless, the litigation has focused greater attention on the ability of states following so-called "convenience of the employer" rules[29] to tax the income of employees working beyond their borders during the pandemic and beyond.[30]

Beyond temporary state telework guidance, several states made more permanent legislative changes to their income tax withholding policies in response to widespread remote work. For example, Kansas enacted legislation giving employers the option to withhold income taxes based on the employee's primary work location for wages paid to teleworking employees through Dec. 31, 2022.[31] In reversing previous administrative positions adopting a form the "convenience" rule, Arkansas enacted legislation clarifying that a non-resident employee must be physically located in the state when working in order to be subject to the state's income tax.[32] Finally, in an effort to attract remote workers to its state, Louisiana enacted a law providing a 50% income tax exemption for "digital nomads" who move to the state, or teleworkers who work for an out-of-state employer and establish domicile in Louisiana after Dec. 1, 2021.[33]

[23] For further discussion, see GT SALT Alert: "Tax challenges expected from widespread remote work."

[24] For example, Maine and Pennsylvania ended their "status-quo" income tax sourcing policies and nexus relief on June 30, 2021, after which traditional rules and policies would apply. Maine Tax Alert No. 14, COVID-19 Tax Provisions to Expire, Maine Revenue Services, June 2021; Telework Guidance, Pennsylvania Department of Revenue, updated June 17, 2021, https://www.revenue.pa.gov/COVID19/Telework/Pages/default.aspx. New Jersey's temporary employer withholding rules and nexus relief ended effective Oct. 1, 2021. Teleworking – End of COVID-19 Temporary Suspension Period for Nexus and Withholding Purposes, New Jersey Division of Taxation, Aug. 3, 2021, https://www.state.nj.us/treasury/taxation/covid19-payroll.shtml.

[25] SC Information Letter #21-22, Extended Tax Relief – Nexus and Income Tax Withholding Requirements for Employers with Workers Temporarily Working Remotely as a Result of COVID-19, South Carolina Department of Revenue, Aug. 25, 2021; Withholding Tax Update 2021-1, Wisconsin Department of Revenue, Nov. 2021.

[26] MASS. REGS. CODE tit. 830, § 62.5A.3, expired Sep. 13, 2021.

[27] New Hampshire v. Massachusetts, U.S. Supreme Court, No. 22O154, filed Oct. 19, 2020.

[28] Motion for leave to file bill of complaint denied, June 28, 2021.

[29] States and localities following a "convenience" rule source employee income to their state or locality if the employees work remotely for their own convenience rather than as a requirement of their employer that is located in the taxing state. States and localities following this rule include New York, Connecticut, Delaware (and Wilmington), Nebraska, Pennsylvania (and Philadelphia) and certain Ohio municipalities.

[30] For example, tax professor Edward Zelinsky recently filed a legal challenge asking New York to revisit the aggressive interpretation of its "convenience" rule in the context of expanded interstate remote work. Zelinsky alleged due process and commerce clause violations due to the extraterritorial taxation of income earned from his Connecticut home in 2019. Matter of Edward Zelinsky, No. 830517, N.Y. Division of Tax Appeals, filed July 22, 2021.

[31] Kan. S.B. 47, § 9, Laws 2021.

[32] Ark. Act. 1019 (S.B. 484), Laws 2021.

[33] La. S.B. 31, Laws 2021. The income tax exemption is capped at $150,000 on an annual basis and available to remote workers for up to two years through 2025. S.B. 31, § 1, adding LA. REV. STAT. § 47:291.16.B.1, I.

With remote work becoming a regular part of business operating models in 2021, employers were faced with a wide range of often conflicting state tax policies to navigate as many consider making more permanent changes to their teleworking policies. Expiring administrative guidance in 2021 is likely to impact companies with employees working in locations different from their traditional location prior to the pandemic. Some companies may have started tracking employee locations for the first time to make accurate payroll tax reporting and business tax filing decisions. Others may have given more thought to crafting policies setting remote work parameters to minimize additional tax withholding and filing obligations. Beyond 2021, employers will likely need to revisit their policies and update their systems and processes on a regular basis to address the continued disparity in state tax approaches to remote work.

4. Conformity to CARES Act/ PPP loan forgiveness

On March 27, 2020, the federal government enacted the Coronavirus Aid, Relief and Economic Security (CARES) Act[34] which contained significant tax provisions in response to the pandemic, many of which provided taxpayer-favorable changes to the TCJA.[35] The major corporate income tax provisions in the CARES Act included changes to the net operating loss (NOL) rules,[36] modifications to the business interest expense deduction limitation,[37] and the retroactive reclassification of qualified improvement property (QIP) to be eligible for 100% bonus depreciation.[38] Although many states addressed CARES Act conformity during 2020, a significant number of states first considered the CARES Act during their 2021 legislative sessions. Some states that adopt the Internal Revenue Code (IRC) as of a specific date were required to consider the CARES Act as they enacted legislation in 2021 that advanced their IRC conformity dates past the enactment date of the CARES Act.

States have taken a variety of approaches to the CARES Act in 2021, but the unique approaches taken by Colorado, Florida and Virginia merit special consideration. Early in 2021, Colorado enacted legislation allowing a subtraction for the 2021 tax year for expenses disallowed by the state's CARES Act decoupling legislation enacted in 2020.[39] For many taxpayers, the required state addbacks resulted in a permanent disallowance of certain deductions. The 2021 legislation provides for a limited recapture of these disallowed deductions in tax years beginning on or after Jan. 1, 2021.[40]

On June 29, 2021, Florida enacted legislation advancing the IRC conformity date from Jan. 1, 2020, to Jan. 1, 2021, but decoupling from the temporary CARES Act provisions addressing the business interest expense limitation.[41] Instead, for the 2019 and 2020 tax years, businesses are required to compute a modification to taxable income by adding back the excess of all of the business interest expense as calculated under the CARES Act, minus all of the business interest expense that would be deductible if calculated pursuant to the TCJA.[42] Any amount added back is treated as a disallowed business interest expense carryforward until it has been utilized.[43] Florida also decouples from the retroactive QIP corrective provisions contained in the CARES Act.[44]

Virginia enacted legislation that advanced the IRC conformity date from Dec. 31, 2019, to Dec. 31, 2020.[45] By advancing the IRC conformity date to the end of 2020, the legislation generally conformed to the CARES Act, but specifically decoupled from three provisions related to decreases in taxable income: (i) the suspension of NOL limitations for the 2018-2020 tax years; (ii) the suspension of the excess business loss limitation for the 2018–2020 tax years; and (iii) raising the business interest limitation for the 2019 and 2020 tax years.[46] In effect, Virginia taxpayers were required to file their returns as if these provisions of the CARES Act were never enacted. Additionally, as the decoupling was retroactive, some taxpayers were required to file amended prior year Virginia income tax returns.

The CARES Act created the Paycheck Protection Program (PPP) to provide forgivable business loans when the recipient meets certain eligibility criteria.[47] Under the express terms of the CARES Act, forgiven loan amounts are excluded from the borrower's gross income.[48] The Internal Revenue Service (IRS) initially disallowed deductions for payments of eligible business expenses that ultimately resulted in forgiveness of a covered loan,[49] but federal legislation enacted late in 2020, the Consolidated Appropriations Act, 2021 (CAA), broadly allows for the deductibility of business expenses paid with forgiven PPP loan proceeds.[50]

[34] P.L. 116-136 (2020).
[35] P.L. 115-97 (2017).
[36] Prior to the CARES Act, the TCJA imposed an 80% limitation on the use of NOLs generated after 2017. The CARES Act temporarily suspended this limitation to allow federal NOLs to be fully deductible for tax years beginning in 2018 through 2020. Federal law continues to allow the indefinite carryforward of NOLs enacted in the TCJA. The TCJA eliminated the carryback of NOLs, but the CARES Act allows the carryback of any NOL generated in a tax year beginning in 2018 through 2020 for up to five years. IRC § 172.
[37] The TCJA modified IRC § 163(j) to limit business interest deductions to 30% of a taxpayer's adjusted taxable income (ATI). The CARES Act increased the percentage threshold from 30% to 50% of a taxpayer's ATI for tax years 2019 and 2020. Taxpayers may also elect to use their 2019 ATI to calculate their allowable interest expense deduction in 2020.
[38] IRC § 168(e)(3)(E)(viii), (e)(6)(A), (g)(3)(B).
[39] H.B. 21-1002, Laws 2021, adding COLO. REV. STAT. § 39-22-304(3)(p). See GT SALT Alert: "Colorado creates CARES Act modifications."
[40] A deduction is allowed for the 2021 tax year, but the amount is limited to the lesser of the taxpayer's Colorado taxable income or $300,000. Excess amounts may be deducted in future tax years until the entire deduction amountis exhausted. However, the deduction for the 2022 through 2025 tax years is limited to the lesser of Colorado taxable income or $150,000.
[41] Ch. 242 (H.B. 7059), Laws 2021. See GT SALT Alert: "Florida advances federal conformity date."
[42] FLA. STAT. ANN. § 220.13(1)(e)4.
[43] Id.
[44] FLA. STAT. ANN. § 220.13(1)(e)1.c, 5.a.
[45] Ch. 117 (H.B. 1935) and Ch. 118 (S.B. 1146), Laws 2021. GT SALT Alert: "Virginia advances IRC conformity date one year."
[46] VA. CODE ANN. § 58.1-301.B.7-9; Tax Bulletin 21-4, Virginia Department of Taxation, March 15, 2021.
[47] P.L. 116-136.
[48] See P.L. 116-136, § 1106(i).
[49] Notice 2020-32, 2020-21 I.R.B. 837 (May 18, 2020); Rev. Rul. 2020-27, 2020-50 I.R.B. 1552 (Dec. 7, 2020) (declared obsolete by Rev. Rul. 2021-2; 2021-4 I.R.B. 495 (Jan. 6, 2021)).
[50] P.L. 116-260, § 276(a).

While most states decided to conform to the federal PPP loan provisions, a few states diverge from the federal treatment. California enacted legislation in 2020 addressing the treatment of PPP loans, but this legislation was enacted prior to the CAA.[51] On April 29, 2021, California enacted legislation providing greater conformity to federal law regarding the deductibility of expenses paid using forgiven PPP loans.[52] Deductions for expenses paid using PPP loan proceeds are allowed even when the loan is forgiven provided the taxpayer is not an "ineligible entity."[53] In contrast, Hawaii excludes the loan forgiveness amounts from gross income but decouples from the federal treatment by disallowing the deduction if the expenses paid by a taxpayer entitle it to PPP loan forgiveness and the taxpayer has a reasonable expectation of forgiveness.[54] For tax years beginning on or after Jan. 1, 2020, Rhode Island requires the addition of the amount of any PPP loan forgiven for federal purposes to the extent the amount of loan forgiven exceeds $250,000.[55] Also, Virginia taxpayers seeking to take advantage of the CAA allowance to deduct business expenses which were funded by a PPP loan are limited to a $100,000 deduction.[56]

[51] Ch. 39 (A.B. 1577), Laws 2020.
[52] Ch. 17 (A.B. 80), Laws 2021. For further information, see GT SALT Alert: "California aligning with fed PPP loan treatment."
[53] An "ineligible entity" is a taxpayer that either: (i) is a publicly-traded company; or (ii) does not experience a 25% reduction in gross receipts in an applicable quarter of 2020 as compared to the same quarter in 2019. CAL. REV. & TAX. CODE §§ 17131.8(g)(3); 24308.6(g)(3).
[54] Tax Information Release No. 2021-05, Hawaii Department of Taxation, July 2, 2021.
[55] Ch. 162 (H.B. 6122), Laws 2021, adding R.I. GEN. LAWS § 44-1-7(d); amending R.I. GEN. LAWS § 44-11-11-(a)(1); Advisory (Adv) 2021-39, Rhode Island Division of Taxation, Oct. 20, 2021; Advisory (Adv) 2021-34, Rhode Island Division of Taxation, Sep. 1, 2021; Notice 2021-01, Rhode Island Division of Taxation, July 7, 2021.
[56] Ch. 117 (H.B. 1935) and Ch. 118 (S.B. 1146), Laws 2021, amending VA. CODE ANN. § 58.1-301.B; adding VA. CODE ANN. § 58.1-402.H; Tax Bulletin 21-4, Virginia Department of Taxation, March 15, 2021. For further information, see GT SALT Alert: "Virginia advances IRC conformity date one year."

5. Remaining states enact remote seller laws

By the end of 2020, nearly all states imposing a sales tax had adopted remote seller and marketplace facilitator nexus legislation in response to Wayfair.[57] As a result of legislation enacted by Florida, Kansas and Missouri during 2021, this trend has become unanimous and all states with a sales tax have adopted remote seller and marketplace facilitator nexus provisions. This development is particularly noteworthy because all states with a sales tax decided to follow Wayfair within just three years of the decision. However, there remain differences in the thresholds and application of the standards among states. In some states, a remote seller has nexus if it satisfies an annual sales threshold or a transaction threshold. Other states only have a sales threshold and a few states have a sales threshold that is greater than $100,000.

The new sales tax nexus requirements were effective in Florida and Kansas on July 1, 2021, but they are not effective in Missouri until Jan. 1, 2023. Specifically, Florida enacted legislation on April 19, 2021, requiring remote sellers with at least $100,000 in retail sales to Florida purchasers in a calendar year to collect and remit Florida sales tax.[58] The legislation also requires marketplace facilitators with at least $100,000 in Florida sales to collect tax on behalf of marketplace sellers that make sales facilitated through a marketplace. On May 3, 2021, the Kansas legislature voted to override Gov. Laura Kelly's veto of omnibus legislation imposing a sales tax collection and remittance requirement for remote sellers and marketplace facilitators exceeding a $100,000 sales threshold.[59] Prior to this legislation, Kansas was the only state to impose a collection obligation on remote sellers without any safe-harbor sales thresholds.[60] On June 30, 2021, Missouri enacted legislation that provides a sales tax nexus standard of $100,000 and a marketplace facilitator collection requirement that are effective on Jan. 1, 2023.[61]

[57] South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).
[58] Ch. 2021-2 (S.B. 50), Laws 2021, amending FLA. STAT. §§ 212.0596(1)-(4); adding FLA. STAT. § 212.05965. For further discussion of this legislation, see GT SALT Alert: "Florida enacts remote seller economic nexus."
[59] S.B. 50, Laws 2021, §§ 1–4. See GT SALT Alert: "Kansas law addresses Wayfair, TCJA provisions."
[60] Under Notice 19-04, Kansas Department of Revenue, Aug. 1, 2019, remote sellers without a physical presence in Kansas were required to collect and remit sales tax on sales of tangible personal property and services regardless of the volume of sales or number of transactions. The notice referred to a statute giving Kansas the authority to require retailers doing business in the state to collect and remit tax under the provisions of the U.S. Constitution.
[61] S.B. 153, Laws 2021, amending MO. REV. STAT. § 144.605(2)(e); adding MO. REV. STAT. § 144.752.

6. Courts decline remote seller sales tax challenges

In 2021, several federal district courts declined to consider sales tax litigation brought by remote sellers, particularly in cases when an alternative remedy could be obtained at the state level. Several states have asserted inventory nexus for remote sellers participating in the Fulfillment by Amazon (FBA) program prior to the enactment of marketplace facilitator laws. Under the FBA program, smaller online sellers may not know where their inventory is stored or where their products are eventually sold, which may result in sales tax assessments from states in which remote sellers have otherwise limited connections.

There were at least three cases in 2021 in which federal courts dismissed claims made by online sellers. A Pennsylvania federal court rejected a challenge from a group of online sellers to Pennsylvania's assertion of sales tax nexus on out-of-state businesses having in-state inventory through the FBA program.[62] In a similar case, an Illinois federal court rejected an Illinois online seller's motion for a preliminary injunction against the California Department of Tax & Fee Administration (CDTFA) for seizing the seller's bank account in an effort to collect prior California sales taxes allegedly owed on the basis of inventory stored in Amazon warehouses located in California.[63]

Under the federal Tax Injunction Act (TIA), the federal court lacked subject matter jurisdiction to hear the case because the online seller could pursue a plain, speedy and efficient remedy in California state court. In a case filed by the same group that filed the Pennsylvania litigation discussed above, a California federal court rejected a motion for a preliminary injunction against the CDTFA for pursuing back sales taxes from sellers with inventory located in Amazon fulfillment centers in the state.[64] The court determined that it lacked subject matter jurisdiction to hear the case under the TIA because a remedy was available to the taxpayers in California state court.

Online sellers are likely to argue that the pattern of federal courts dismissing sales tax controversies is inequitable, particularly when their only connection with a state may result from inventory moved into a state on a transitory basis without their knowledge as a result of the FBA arrangement. Federal courts may be more sympathetic to this argument than state courts, and that might have been a significant reason why this litigation has been pursued in federal rather than state venues. However, there is a relatively high bar for sales tax cases to proceed in federal court because the TIA creates a barrier to taxpayer claims for relief. These decisions, which could force small online sellers to pursue their claims in state court rather than federal court, make it even more difficult for these sellers to pursue these appeals and often must pay the assessed tax prior to pursuing a refund claim.

Taxpayers also are filing lawsuits in federal court to challenge the few states that do not have centralized sales tax systems.[65] A family-owned business located in Arizona that sells products online is challenging the complex system in Louisiana that requires the state's 64 parishes to collect sales and use tax and set their own tax rates. The taxpayer is arguing that "Louisiana's requirement that out-of-state sellers register and file reports with every Louisiana parish" is "an undue burden on interstate commerce and a violation of due process."

[62] Online Merchants Guild v. Hassell, U.S. District Court for the Middle District of Pennsylvania, No. 1:21-cv-00369, May 28, 2021.
[63] Rubinas v. Maduros, U.S. District Court for the Northern District of Illinois, Eastern Division, No. 1:21-CV-00096, Sept. 16, 2021. See GT SALT Alert: "Federal court passes on California sales tax suit."
[64] Online Merchants Guild v. Maduros, U.S. District Court for the Eastern District of California, No. 2:20-cv-01952, Oct. 13, 2021. For further information, see GT SALT Alert: "Federal court dismisses California sales tax suit."
[65] Halstead Bead, Inc. v. Lewis, U.S. District Court for the Eastern District of Louisiana, No. 2:21-cv-02106, complaint filed on Nov. 15, 2021.

7. Digital advertising taxes considered

In February 2021, Maryland became the first state to enact a gross receipts tax on proceeds derived from digital advertising services in the state.[66] Enacted by the state legislature over the objections of the Maryland governor, who vetoed the legislation, the tax is imposed on entities with global gross revenues of at least $100 million. Entities having annual gross revenues derived from digital advertising services in Maryland of at least $1 million in a calendar year are required to file a tax return.[67] The tax rate ranges from 2.5% to 10% based on the amount of the entity's annual global gross revenue.[68] While the tax was enacted with the intent of taxing large technology companies, the tax may also impact other non-technology companies deriving digital advertising revenue from the state.

Maryland's digital ad tax has been the source of controversy since the day it was enacted. Although the legislation intended for the tax to be effective beginning with the 2021 tax year, subsequent emergency legislation delayed the effective date of the tax to the 2022 tax year due to various difficulties in implementing the tax.[69] The delayed effective date was also the result of lawsuits that were filed in both state and federal court alleging a violation of electronic commerce under the Internet Tax Freedom Act (ITFA) as well as the Commerce and Due Process Clauses of the U.S. Constitution.[70] In response to widespread criticism of the tax, the corrective legislation also amended the statute to provide that "digital advertising services" does not include advertising services or digital interfaces owned or operated on behalf of a broadcast or news media entity. Additionally, the subsequent legislation prohibits digital advertisers from passing on the cost of the tax to customers purchasing digital advertising services via a separate fee, surcharge or line-item.

Beyond the legal challenges and legislative amendments, additional practical obstacles remain regarding the implementation of the tax. First, the enacting legislation raises questions as to who is subject to the tax due to the lack of definitions currently contained in the statute. The state legislature delegated much of the substantive aspects of the law to the Maryland Comptroller, whose office is responsible for the administration and enforcement of the tax but has released only limited guidance concerning the tax to date. In a bulletin released earlier this year, the Comptroller clarified that the first quarterly estimated tax payment for the tax will be due on April 15, 2022, and based on first quarter 2022 revenues.[71]

Second, the tax presents various compliance issues for impacted taxpayers, including difficulties in determining whether an entity derives at least $1 million in revenue from "digital advertising services in Maryland" and thus has a filing obligation. In response, the Comptroller issued final regulations in early December providing rules for the sourcing of digital advertising tax revenue.[72] The rules provide that revenue is sourced based on the location of the device accessing the ad content, and that taxpayers may use available information within their possession or control to identify a device's location, including IP addresses, geolocation data, cookies, industry standard metrics or "any other comparable information" to determine where each device is located.[73] While these regulations provide taxpayers with some latitude to determine device locations, they are likely to raise additional questions with respect to difficulties in pinpointing locations of portable devices that are in transit when ads are being accessed.

[66] Md. Ch. 37 (H.B. 732), Laws 2021; vetoed by Maryland Gov. Larry Hogan, May 7, 2020; final vote to override veto of both bills, Feb. 12, 2021. For further discussion of the Maryland digital advertising tax, see GT SALT Alert: "Maryland enacts digital ad gross revenues tax."
[67] MD. CODE ANN., TAX-GEN. §§ 7.5-201(a); 7.5-301(a).
[68] MD. CODE ANN., TAX-GEN. § 7.5-103.
[69] Md. S.B. 787, Laws 2021.
[70] Four business associations filed a lawsuit against the Maryland Comptroller in Maryland federal court seeking a declaration and injunction against enforcement of the tax. U.S. Chamber of Commerce et al. v. Franchot, No. 1:21-cv-00410, U.S. District Court for the District of Maryland, Northern Division, filed Feb. 18, 2021. Subsequently, Comcast and Verizon filed a complaint in state court seeking a declaration that the digital advertising tax is illegal under the ITFA, also claiming due process and commerce clause violations. Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia LLC et al. v. Maryland Comptroller of the Treasury, No. C-02-CV-21-000509, Circuit Court for Anne Arundel County, Md., filed Apr. 15, 2021.
[71] Tax Bulletin 21-2, Applicability Date of Digital Advertising Gross Revenues Tax Delayed, Maryland Comptroller, May 2021.
[72] MD. CODE REGS. § 03.12.01.01-06, Maryland Comptroller, effective Dec. 13, 2021.
[73] MD. CODE REGS. § 03.12.01.02(C).

Although the future of Maryland's digital advertising tax remains very uncertain, the state's experience has paved the way for other state legislatures to consider their own digital advertising tax bills, with legislation having been proposed in Connecticut, Massachusetts, Montana, New York, Texas and West Virginia.[74] Other states introduced legislation that would tax social media advertising on a gross receipts basis, including Arkansas, Connecticut and Indiana.[75] Although these bills have failed to gain traction during the 2021 state legislative sessions to date, they are indicative of a potential movement to tax the digital economy as a way to seek additional revenue sources from entities that may otherwise have no other connection with the taxing state. Before proceeding with their own digital advertising taxes, all eyes are on Maryland to see whether the state will be successful in implementing its digital advertising tax in the face of ongoing legal and compliance challenges.

[74] Conn. H.B. 6187; Mass. H. 2894; Mass. H. 3081; Mont. H.B. 363; N.Y. S. 1124, Tex. H.B. 4467; W.V. S.B. 605.
[75] Ark. S.B. 558; Conn. H.B. 5645; Ind. H.B. 1312.

8. Recent NOL developments

From a federal perspective, the TCJA and the CARES Act made significant changes to the historic treatment of net operating losses (NOLs) for federal income tax purposes. The TCJA provisions specifically limit allowable NOL deductions to 80% of federal taxable income and lift the previously imposed 20-year limitation on carryovers. While the TCJA provisions disallowed NOL carrybacks, the CARES Act temporarily and retroactively allows NOLs incurred in tax years beginning in 2018, 2019, or 2020 to be carried back five years or carried forward indefinitely, at the taxpayer's election. From a federal standpoint, this change was intended to grant taxpayers a degree of relief from the economic difficulties created by the pandemic.

Over the past 12 months, as states have reckoned with their own financial difficulties and made decisions regarding whether and how to conform to the many significant tax provisions included in the TCJA and the CARES Act, NOL treatment has certainly not escaped notice. In efforts to address their own budgetary woes and maximize revenue, several states have acted to limit taxpayers' ability to offset taxable income with recognized losses. Significant legislative and judicial developments in Illinois, Pennsylvania and New Jersey highlight imposed limitations on NOL usage.

During 2021, Illinois enacted a fiscal 2022 budget bill including a temporary limitation of its NOL carryover deduction.[76] Specifically, the legislation limits C corporations to a deduction of $100,000 of NOL carryforwards for each taxable year ending on or after Dec. 31, 2021, and prior to Dec. 31, 2024. This is not Illinois' first foray into restricting NOL usage as a means to raise tax revenue and close its budget gap. Previously, a similar limitation applied for taxable years generally ending in 2012 and 2013. If a corporation is impacted by the limitation in a given year, that year will not be included in determining the 12-year carryforward period in which previously generated NOLs must be used.

In Pennsylvania, challenges to its concept of an operating loss attribute, the net loss carryover (NLC), have resulted in several significant judicial decisions in recent years. Pennsylvania law generally allows corporate taxpayers to carry forward unused prior net losses in order to reduce the amount of taxable income subject to Pennsylvania corporate net income tax (CNIT) in future years. However, legislation enacted during the 1990s temporarily suspended the deduction before reintroducing it with a fixed dollar limitation on the amount of net loss a taxpayer could claim. Subsequently, the legislature amended the legislation to allow taxpayers to claim the greater of: (i) a fixed dollar amount; or (ii) a relatively small percentage of taxable income. In 2017, the Pennsylvania Supreme Court addressed the constitutionality of the limitation and struck down the fixed dollar limitation provision of the NLC statute as applied to the challenging taxpayer during the 2007 tax year.[77] In fashioning a remedy, the court severed the fixed-dollar cap from the NLC provision, while retaining the percentage limitation. Subsequently, the Pennsylvania Department of Revenue published a bulletin clarifying its policy to apply the remedy on a prospective basis.[78]

In addressing the most recent challenge to the NLC statute during 2021, the Pennsylvania Commonwealth Court found that a taxpayer was not entitled to a refund of CNIT paid for the 2014 tax year when the taxpayer's use of NLCs was limited by the state's percentage limitation for net loss deductions.[79] In denying the refund, a three-judge panel found that the Pennsylvania Supreme Court's decision in Nextel does not require a retroactive elimination of the percentage limitation based on the taxpayer's income. Instead, the court ruled that prospective application of Nextel to the taxpayer's facts did not violate the Uniformity and Remedies Clauses of the Pennsylvania Constitution, or the Due Process or Equal Protection Clauses of the U.S. Constitution. Thus, Pennsylvania was free to apply its NLC percentage limitation. The next chapter in the NLC interpretive saga is likely to come soon, with the Pennsylvania Supreme Court currently considering an appeal of General Motors Corp. v. Pennsylvania,[80] in which Pennsylvania's flat-dollar limitation will be considered.

[76] P.A. 102-0016 (S.B. 2017), Laws 2021.
[77] Nextel Communications of the Mid-Atlantic v. Pennsylvania, 171 A.3d 682 (Pa. 2017).
[78] Corporation Tax Bulletin 2018-02, Net Operating Loss (NOL) Deduction Application of Nextel Communications v. Commonwealth, Pa. Dept. of Rev., May 10, 2018.
[79] Alcatel-Lucent USA Inc. v. Pennsylvania, Pennsylvania Commonwealth Court, No. 803 F.R. 2017, Sept. 13, 2021.
[80] 222 A.3d 454 (Pa. Commonwealth 2019).

Finally, addressing an attempt by the New Jersey Division of Taxation to disallow the usage of NOLs, the New Jersey Tax Court found during 2021 that the Division may not disallow NOLs generated in closed tax years and carried forward to an open tax year under an audit examination.[81] Specifically, the Tax Court found the Division's adjustment of NOL carryforwards created in closed years was tantamount to the adjustment of income reported in those years, thus constituting an impermissible "audit" for closed years outside the state's four-year statute of limitations. The decision confirms that the Division cannot adjust NOLs generated in tax periods falling outside the four-year statute of limitations and carried forward to offset income in open tax years that are audited. Further, it clarifies that NOLs from tax years that are otherwise closed cannot be disallowed even when they impact the computation of income for open years. The Division may still appeal this determination.

The recent legislative change in Illinois and decisions in New Jersey and Pennsylvania highlight only a few of the states' continuing efforts to limit the use of NOLs in efforts to raise revenue and balance their budgets in these challenging times. As the economic effects of the pandemic continue to evolve, a spotlight is likely to remain on the ever-changing landscape of NOL treatment for state income tax purposes.

[81] R.O.P. Aviation, Inc. v. Director, Division of Taxation, N.J. Tax Court, No. 01323-2018, May 27, 2021.

9. MTC updates statement on Public Law 86-272

After approximately two years of work, the Multistate Tax Commission (MTC) voted in August to adopt revised guidance interpreting longstanding federal protections against state income tax to update for the modern economy and internet business activities.[82] With 19 member states and the District of Columbia voting in favor, the MTC approved an updated statement of information interpreting Public Law 86-272 (P.L. 86-272), the 1959 federal law that limits the state taxation of income from sales of tangible personal property if the taxpayer's only business activities in the state are the solicitation of orders that are approved and shipped from outside the state.[83] The adoption marks the most significant revisions to the statement since its last revision in 2001.

Shortly after the U.S. Supreme Court decided South Dakota v. Wayfair in 2018, the MTC decided that the emphasis on taxpayer protection under P.L. 86-272, coupled with the growing popularity of more technology-dependent business models, required revisions to its statement of information. Accordingly, the MTC formed a work group that released a proposed revised statement in February 2020, which was approved by the MTC Uniformity Committee in April 2020. A public hearing was held in August 2020, after which the hearing officer released a report in support of the proposed revisions in October 2020. After survey and approval by the MTC's 16 compact member states and eight sovereignty member states, the statement was approved by the MTC's Executive Committee in August 2021.

Most significantly, the revised statement includes a new subsection to determine what constitutes protected or unprotected activities under federal law, specifically addressing activities conducted using the internet. The statement establishes the general rule that when a business interacts with a customer via the business's website or app, it is engaged in "business activity" within the customer's state, meaning that the activities extend beyond the solicitation of orders for sales of tangible personal property, thereby exceeding the protections of P.L. 86-272. Alternatively, if the website merely presents static text or photos, there is no engagement or facilitation within the customer's state.

The statement provides a listing of 11 different activities conducted by internet businesses and explains whether they are protected or unprotected for P.L. 86-272 purposes. Activities such as post-sale assistance to a customer utilizing an electronic chat or email icon are considered unprotected because they are not ancillary to in-state solicitation. In contrast, posting an online list of static frequently asked questions with answers is considered a protected activity. The statement provides a list of additional unprotected activities, which include solicitation and receipt of online applications for credit cards, employment invitations, extended warranty offerings, placement of certain internet cookies, remote repair, audio and video streaming, and the use of marketplace facilitators. Interestingly, the revised statement adopts the U.S. Supreme Court's analysis in Wayfair that virtual contacts are "relevant to the question of whether a seller is engaged in business activities in states where its customers are located" for purposes of P.L. 86-272, even though the Court did not address P.L. 86-272 in its decision.

[82] Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272, Multistate Tax Commission, revised Aug. 4, 2021. For background regarding MTC efforts to update the P.L. 86-272 statement of information, see GT SALT Alert: "MTC reviewing fed laws covering state income tax."

[83] Pub. L. No. 86-272, 15 U.S.C. §§ 381-384.

The revised statement has been met with mixed reaction to date. Some question the role of the MTC to read into a federal statute an understanding of internet activity that could subject businesses to additional income tax filing obligations without having any physical presence in the taxing state. Others argue that the statement essentially renders the federal law meaningless by further limiting the scope of protected activities when applied to internet commerce. In response, the MTC maintains that until Congress updates P.L. 86-272, states are compelled to determine how the federal statute should apply to modern business transactions. Given these competing views, it should be noted that the states are not bound by the MTC's interpretation and are responsible for individually adopting the principles of the revised statement. If that happens through a formal announcement by a state tax authority, or informally through an audit policy that becomes evident over time, affected businesses are likely to challenge the authority of states to limit the application of P.L. 86-272 to internet transactions.

10. Tax regimes targeting the few

As states and localities have continued to feel the economic pain induced by the pandemic (mitigated to be sure by ARPA funds), some have sought to impose new sources of tax revenue which are designed to intentionally target small groups of taxpayers. Prime examples of this targeted approach include the adoption of billboard taxes by the cities of Cincinnati and Baltimore and a long-term capital gain (LTCG) tax, as well as a business and occupation (B&O) surtax on large financial institutions, by the state of Washington. Although raising funds in this manner may be politically acceptable to many, it also attracts the potential for meaningful legal challenges. During 2021, courts considered constitutional challenges to the municipal billboard taxes and the B&O surtax.

First, a Maryland Court of Appeals decision upheld the City of Baltimore's tax on the privilege of selling advertising space on billboards against First Amendment claims.[84] The Maryland decision, which has been appealed to the U.S. Supreme Court, concluded that the tax at issue did not single out the press and noted that the Baltimore tax had no effect on the billboard owners' circulation of messages. In contrast, the Ohio Supreme Court ruled on Sept. 16 that an excise tax imposed upon a small number of billboard operators by the City of Cincinnati violates the rights to freedom of speech and free press protected by the First Amendment to the U.S. Constitution.[85] In doing so, the Court permanently enjoined enforcement of the tax. The Ohio Supreme Court clearly distinguished its conclusion from the Maryland decision, which concluded that the tax at issue did not single out the press and had no effect on the billboard owners' circulation of messages. In contrast, the Cincinnati billboard operators presented uncontradicted evidence that the billboard tax would lead to removal of their less profitable billboards. Further, the Ohio Supreme Court disagreed with the Maryland Court of Appeals' analysis of whether the practical application of the Baltimore billboard tax to only a small number of speakers presented a constitutional issue. The divergent outcomes reached by appeals courts in Ohio and Maryland on their relatively similar taxes on billboards may make these controversies a possibility for the U.S. Supreme Court to consider in the coming months.

Also during 2021, the Washington Supreme Court rejected a facial constitutional challenge to the B&O surtax on large financial institutions.[86] Enacted during 2019 and effective Jan. 1, 2020, the legislation at issue requires that specified financial institutions pay an additional tax of 1.2% of gross income taxed under the service and other activities' B&O tax classification.[87] Specifically, the court found that because the tax applies equally to in- and out-of-state institutions and is limited to Washington-related income, it does not discriminate against interstate commerce.

Like the billboard taxes and B&O surtax targeting small groups of individuals, the Washington tax on LTCG scheduled to take effect Jan. 1, 2022, and intended to provide additional funds to support the state's K-12 education system is already facing legal challenges. Specifically, Washington enacted legislation imposing a 7% tax on LTCG of individuals in excess of $250,000 resulting from the sale of certain capital assets by Washington resident individuals.[88] Notably, Washington has unique restrictions limiting the imposition of state and local taxes.

[84] Clear Channel Outdoor, Inc. v. Dir., Dept. of Fin. of Baltimore, 472 Md. 444 (2021).
[85] Lamar Advantage GP Co., L.L.C. v. Cincinnati, Slip Opinion No. 2021-Ohio-3155, Sept. 16, 2021. See GT SALT Alert: "Ohio ruling: Billboard tax violates 1st Amendment."
[86] Washington Bankers Association v. Dept. of Rev., No. 98760-2, Sept. 30, 2021 (en banc).
[87] H.B. 2167, § 2, WASH. REV. CODE § 82.04.xxx(1). A "specified financial institution" is a financial institution (or a company owned by a financial institution) that is a member of a "consolidated financial institution group" reporting at least $1 billion in annual net income on its consolidated financial statement filed with the Federal Financial Institutions Examination Council for the previous calendar year. H.B. 2167, § 2, WASH. REV. CODE § 82.04.xxx(2)(e)(1).
[88] Ch. 196 (S.B. 5096), Laws 2021. This legislation was enacted on May 4, 2021 and is effective July 25, 2021. See GT SALT Alert: "Washington enacts individual capital gains tax."
[89] WASH. CONST. art. VII, §§ 1, 2.

The Washington State Constitution provides that all taxes on property, defined as "everything, whether tangible or intangible, subject to ownership," must be uniformly applied and cannot exceed an annual rate of 1%.[89] In applying these limitations to previously adopted taxes, the Washington Supreme Court has ruled that taxes on net income are taxes on property subject to the constitutional uniformity and rate limitations.

Critics of the legislation contend that while it may be characterized as an excise tax in the statute, it operates as an unconstitutional income tax. The enactment of this legislation was itself controversial and a law firm preemptively filed a lawsuit in Washington Superior Court for Douglas County on behalf of several taxpayers on April 27, 2021, alleging the tax is unlawful and an invalid income tax under the state's constitution.[90] The plaintiffs have claimed the measure treats similarly situated taxpayers in different ways in violation of the state constitution's uniformity clause. Given the significance of the legislation, the legal proceedings addressing the issue could progress to the Washington Supreme Court.

[90] Quinn v. State of Washington, Department of Revenue, filed in Washington Superior Court for Douglas County.

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