Tax Reform and Other Interesting Issues

August 18, 2021

Christopher Jones

jonesc@ballardspahr.com
215.864.8424

Morgan Klinzing

Morgan.klinzing@troutman
215.981.4560

Wendi Kotzen

kotzenw@ballardspahr.com
215.864.8305

Leila Vaughn

lvaughan@rccblaw.com
484.539.1925

Christopher Jones

Christopher A. Jones advises clients on a wide range of federal, state, and local tax matters. His practice includes advising clients regarding the tax consequences of complex transactions and associated planning opportunities. Additionally, Chris assists clients in federal, state, and local tax audits and controversies and has represented clients in administrative appeals and in court. He provides clients tax advice in labor and other litigation matters including withholding tax and information reporting issues.

Morgan Klinzing

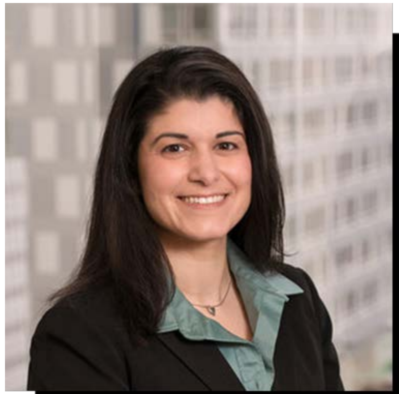
Morgan Klinzing is an associate in the Tax and Estate Practice Group of Troutman Pepper Hamilton Sanders LLP, resident in the Philadelphia office. Ms. Klinzing's practice focuses on federal and international income tax, with a focus on the private equity arena and pass-throughs. She represents clients in domestic and cross border M&A, fund formation and structuring, reorganizations and partnership agreements. Ms. Klinzing is the CLE chair for the Partnership Committee of the Tax Section of the American Bar Association, and a frequent speaker on a variety of transaction tax matters.

Wendi Kotzen

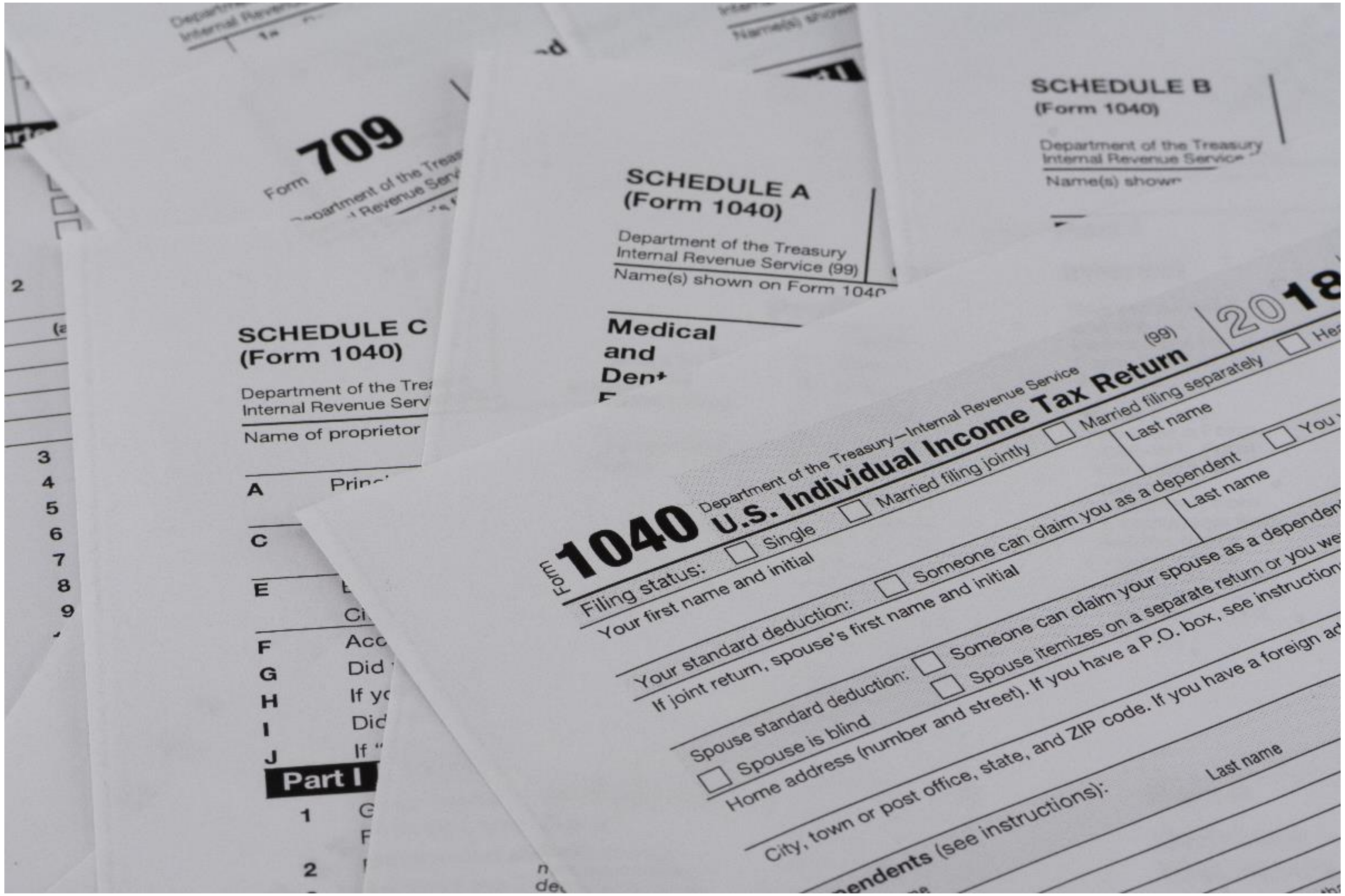
Wendi L. Kotzen is a member of the Real Estate Department and the Practice Leader of Ballard Spahr's Tax Group. Her practice focuses on tax law, including federal, state and local taxation of individuals, corporations, and partnerships. Ms. Kotzen advises clients on the taxation of all types of real estate transactions, has an extensive background in Pennsylvania and Philadelphia realty transfer tax planning, and advises clients in connection with mergers and acquisitions. She provides tax advice in connection with labor and other litigation matters, and she represents clients before federal, state, and local agencies contesting proposed tax adjustments. Also, Ms. Kotzen has an extensive background in working with REITs, real estate partnerships (both for developers and investors), leasing transactions, sale-leasebacks, Pennsylvania state tax incentives, structuring like-kind exchanges (forward, reverse, and TIC exchanges), structuring qualified opportunity zone deals, and workouts.

Leila Vaughan

Leila Vaughan is a member of the Tax Group at Royer Cooper Cohen Braunfeld LLC. Leila advises clients on tax matters relating to business formations, M&A transactions, real estate investments, private equity and non-profit tax exemption. Leila is a Vice Chair of the ABA Tax Section's Sales, Exchanges and Basis Committee and a member of the Philadelphia Bar Association's Tax Council.



Biden Tax Proposals



Individual/Pass-Throughs

- Many individual tax cuts that were enacted in the TCJA expire December 31, 2025.
- This includes the income tax rate reductions, the 199A 20% business income/pass-through deduction, increased estate and gift tax exemptions, etc.

BIDEN Tax Proposals
Individuals and Pass-Throughs – Rates and Itemized Deductions

- The Biden Plan would increase the ordinary income tax rates - top rate would be 39.6% on income over $400,000 (unclear how this would apply to married taxpayers filing jointly and single taxpayers).
- The Biden Plan would cap the benefit of itemized deductions at 28% (as opposed to the to 39.6%) - without restoring the state and local tax deduction – and restore the phase out of some itemized deductions.

BIDEN Tax Proposals
Individuals and Pass-Throughs – Capital Gains Rates

- The Biden Plan would raise the rate on long-term capital gains and the rate on ordinary dividends from the current 23.8% rate (20% plus the 3.8% net investment income tax) to 43.4% (39.6% plus the 3.8% net investment income tax) for taxpayers with income over $1,000,000.

BIDEN Tax Proposals
Individuals and Pass-Throughs – Section 1031 (Like-Kind Exchanges)

- The TCJA eliminated the ability to do a 1031 Exchange for assets other than real estate.
- The Biden plan would eliminate the ability to do a 1031 exchange for real estate for taxpayers with income over $400,000.

BIDEN Tax Proposals

Individuals and Pass-Throughs – Section 199A 20% Business Income/Pass-Through Deduction

- Under the TCJA, individual taxpayers are entitled to a deduction for 20% of their business income, with certain limitations.
- This deduction expires on December 31, 2025.
- The Biden plan would phase out this deduction for taxpayers with incomes exceeding $400,000.

BIDEN Tax Proposals
Individual and Pass-Throughs – Carried Interests

BIDEN Tax Proposals
Individual and Pass-Throughs – Carried Interests

- The TCJA caused long-term capital gain otherwise allocated to the holder of certain carried interests to be taxed as short-term capital gain unless the property sold was held for at least 3 years. The 3 year rule also applies to the disposition of a carried interest.
- Net short-term capital gain is taxed at ordinary income tax-rates

BIDEN Tax Proposals
Individual and Pass-Throughs – Carried Interests

- The Biden plan and the Democrats have talked about tightening the carried interest rules to eliminate certain perceived "loopholes."
  - Potentially perceived as a loophole is the fact that the TCJA carried interest rules do not apply to sales of Section 1231 property – which includes real property used in a trade or business that is held for more than one year
  - Also has discussed taxing all carried interest as ordinary income – eliminating the "loophole"

BIDEN Tax Proposals
FICA Tax Increase

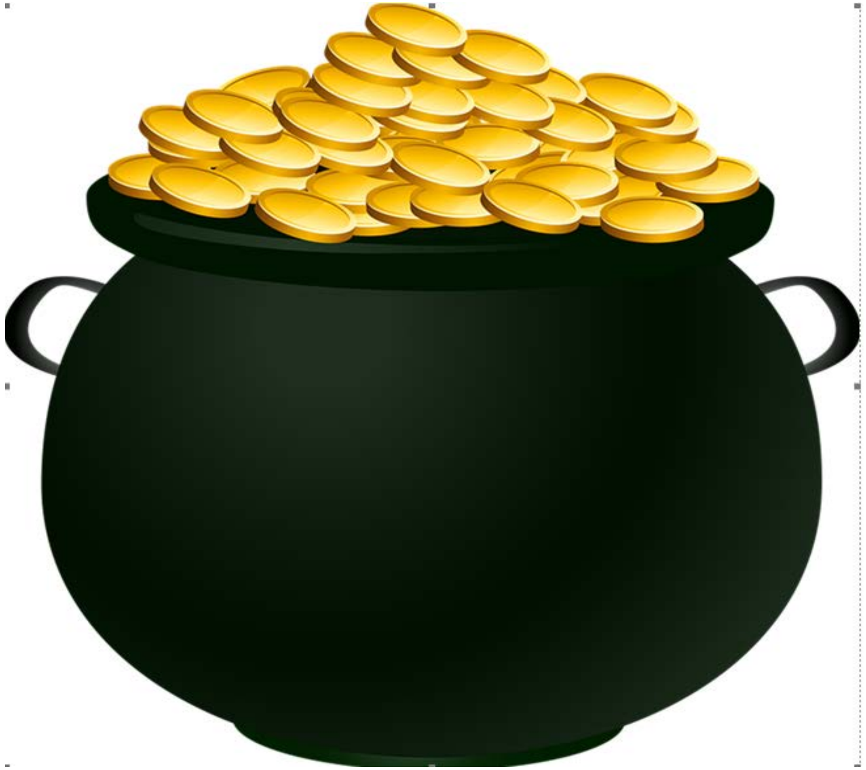
- The Biden Plan would impose additional Social Security tax, at the current rate of 12.4% on wages above $400,000, evenly split between employers and employees.
- Would create a donut hole for wages between $142,800 (the current cap) and $400,000.

BIDEN Tax Proposals
FICA Tax Increase

- Presumably, Social Security tax still will be applied to married individuals separately
  - *i.e.*, Married couple, each earns $300,000; both would be subject to tax only on first $142,800
  - Not 100% clear – Additional Medicare tax currently is imposed on joint income above $250,000; this could be similar

BIDEN Tax Proposals
Qualified Opportunity Zones

- The Biden Plan would retain QOZs



BIDEN Tax Proposals
Qualified Opportunity Zones

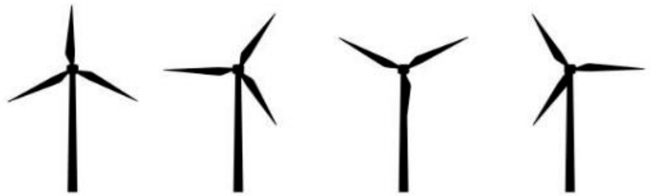
- The Biden Plan to raise long-term capital gain rates would make exemption from tax on exit after an investor held its interest in a qualified opportunity fund for at least 10 years much more advantageous.
- The Biden Plan would revise the focus on partnering with non-profit or community based organizations working to create jobs for low-income individuals.

BIDEN Tax Proposals
Qualified Opportunity Zones

- Also, the Biden Plan would focus Opportunity Zones more on low income communities and require more reporting

BIDEN Tax Proposals
Business Tax Credit Expansion

- New Markets Tax Credits
  - Scheduled expiration December 31, 2021
  - Biden plan would expand the reach of the credits by expanding eligibility and also would make the credit program permanent
- Renewable Energy Credits
  - Both the Investment Tax Credit (Solar) and Production Tax Credit (Wind) are scheduled to phase-out
  - Biden plan would potentially increase the credit amounts and slow or eliminate the phase-out



BIDEN Tax Proposals
Business Tax Credit Expansion

- Biden Plan includes new tax credits including:
  - Manufacturing Communities Tax Credit – Designed to assist businesses in communities impacted by layoffs or government closures
  - 10% "Made in America" Tax Credit – Incentivize restoring, revitalizing, or expanding businesses within the US

BIDEN Tax Proposals
Corporate Tax Corporate Tax Changes

Form **1120**
Department of the Treasury
Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2020 or tax year beginning ...., 2020, ending ...., 20 ......

► Go to www.irs.gov/Form1120 for instructions and the latest information.

OMB No. 1545-0123

2020

A Check if:
1a Consolidated return (attach Form 851)
b Life/nonlife consolidated return
2 Personal holding co. (attach Sch. PH)
3 Personal service corp. (see instructions)
4 Schedule M-3 attached

TYPE OR PRINT

Name

Number, street, and room or suite no. If a P.O. box, see instructions.

City or town, state or province, country, and ZIP or foreign postal code

B Employer identification number

C Date incorporated

D Total assets (see instructions)
$

E Check if: (1) Initial return (2) Final return (3) Name change (4) Address change

Income	1a	Gross receipts or sales	1a
	b	Returns and allowances	1b
	c	Balance. Subtract line 1b from line 1a	1c
	2	Cost of goods sold (attach Form 1125-A)	2
	3	Gross profit. Subtract line 2 from line 1c	3
	4	Dividends and inclusions (Schedule C, line 23)	4
	5	Interest	5
	6	Gross rents	6
	7	Gross royalties	7
	8	Capital gain net income (attach Schedule D (Form 1120))	8
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)	9
	10	Other income (see instructions—attach statement)	10
	11	**Total income.** Add lines 3 through 10 ►	11
...ons (...ons on deductions.)	12	Compensation of officers (see instructions—attach Form 1125-E) ►	12
	13	Salaries and wages (less employment credits)	13
	14	Repairs and maintenance	14
	15	Bad debts	15
	16	Rents	16

BIDEN Tax Proposals
Corporate Income Tax Rate

- Since 1993, corporate income tax rate was 35%
  - Combined with state income tax, U.S. rate was the highest in the OECD
  - This resulted in sophisticated tax planning strategies, such as inversions
- 2017 TCJA lowered the corporate rate to 21%
  - The current rate is slightly above the average OECD (including state income taxes)
- Biden proposes to increase the corporate rate to 28%

BIDEN Tax Proposals
How to accelerate income into 2021

- Installment Sale?
- For QOZs inclusion event that does not end the 10 year benefit?
- Other ideas?

BIDEN Tax Proposals
Section 174 – Research Expenses

- Section 174 provides taxpayers with the option of immediately expensing research and experimentation expenses.
  – Beginning in 2022, the TCJA eliminates the current year deduction option and requires taxpayers to instead capitalize the research expenses and amortize them over 5 tax years
- Biden may first push for repeal of the upcoming 5-year amortization requirement

BIDEN Tax Proposals
GILTI

BIDEN Tax Proposals
Proposed Changes to GILTI

- TCJA introduced a global intangible low-taxed income (GILTI) tax
  - It was a part of the TCJA move away from a worldwide residence based system to a territorial tax on foreign income
- GILTI imposed a minimum tax on investments in foreign assets susceptible to profit shifting
  - Deduction is allowed for Qualified Business Asset Investments (tangible property subject to depreciation used in a trade or business)
- Effective GILTI tax rate is 10.5%

BIDEN Tax Proposals
GILTI Changes

- Biden proposes to modify GILTI by
  - Doubling the GILTI rate to 21%
  - Eliminating the deduction for Qualified Business Asset Investment income and
  - Imposing the GILTI tax on a country-by-country basis (instead of an overall basis)

BIDEN Tax Proposals
Expanded Anti-Inversion Rules

- Section 7874 currently applies to a USCo that is acquired by a FCo if, after the transaction, the former shareholders of the USCo own more than 80% of the FCo.
  - FCo is treated as a US corporation for US FIT purposes.
  - If the former shareholders own between 60-80%, the FCo may have increased tax, but is not treated as a USCo.
- Biden proposes to reduce the 80% threshold to 50%.
  - Expands application to certain transactions regardless of the ownership percentage.

BIDEN Tax Proposals
FDII Repeal

- The TCJA included a deduction for 37.5% of any foreign-derived intangible income (FDII).
- Biden proposes to repeal FDII.

BIDEN Tax Proposals
BEAT Repeal and Replacement with SHIELD

- The base erosion and anti-abuse tax (BEAT) would be replaced with the Stopping Harmful Inversions and Ending Low-Tax Developments (SHIELD).
- SHIELD would disallow deductions to USCos with respect to members in their group whose income is subject to an effective tax rate below 21% (or an OECD agreed rate).
  - Only applies to financial reporting groups with over $500MM in global annual revenue.

BIDEN Tax Proposals
Limit Interest Deductions for Certain US Borrowing

- Biden proposes disallowing certain deductions for interest paid by a member of a multinational group.
- The deduction would be disallowed to the extent it exceeds an amount determined by reference to the entity's proportionate share of the group's net interest expense.

BIDEN Tax Proposals
Tax Incentive for US Job Creation

- Biden proposes a new business credit equal to 10% of certain expenses paid in connection with moving a business to the US to the extent it increases US jobs.
- The proposal would also disallow certain deductions for expenses paid to offshore a US business if it reduces US jobs.

BIDEN Tax Proposals
Bonus Depreciation

BIDEN Tax Proposals
Bonus Depreciation

- Pre-TCJA
  - Since 2002, the Code allowed a first year depreciation deduction (bonus depreciation) of 50%, although it was planned to phase out in 2019
- TCJA
  - extended bonus depreciation to property placed in service before Jan. 1, 2027 and
  - increased allowance to 100% (although in 2023 percentage decreases by 20 percentage points each year, until 0 in 2027)

BIDEN Tax Proposals
Bonus Depreciation

- The TCJA included bonus depreciation for property with a MACRS life of 20 years or less and certain other property.

Property Placed In Service	Bonus
September 27, 2017 – December 31, 2022	100%
January 1, 2023 – December 31, 2023	80%
January 1, 2024 – December 31, 2024	60%
January 1, 2025 – December 31, 2025	40%
January 1, 2026 – December 31, 2026	20%

BIDEN Tax Proposals
Bonus Depreciation

- Applies to “qualified property” – generally depreciable property with a recovery period of 20 years of less
  - Machinery, equipment, computers, appliances, qualified improvement property and furniture generally qualify
- Biden has not directly proposed to eliminate or reduce the availability of bonus depreciation

BIDEN Tax Proposals
Corporate Minimum Tax

Financial Statements and Consolidated Financial Results
for the Fiscal Year Ended March 31, 2020
And
Outlook for the Fiscal Year Ending March 31, 2021

May 13, 2020
Sony Corporation

Financial Statements (Unaudited)	F-1
Consolidated Balance Sheets	F-1
Consolidated Statements of Income (Fiscal year ended March 31)	F-2
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Business Segment Information and Current View Regarding the Impact of the Spread of COVID-19	4
Basic Views on Selection of Accounting Standards	8

BIDEN Tax Proposals
Tax on Minimum Book Income

- Biden proposes a new 15% minimum "book tax"
- Minimum book tax would apply to corporations
  - with $100MM or more in net income
  - that pay little to no federal income tax
- Projected to raise $400 billion over 10 years

BIDEN Tax Proposals
Minimum Book Income

- Book income is a different base than taxable income
  - Book income is based on GAAP – used to report income to investors
- Biden proposes a hybrid GAAP approach – the proposal would allow retention of
  - foreign tax credits and
  - NOL carryovers

BIDEN Tax Proposals
High Frequency Trading Tax

- Biden has proposed to implement a new financial transaction tax
- Every time a person sells a stock, bond or derivative, the government would impose a tax on the transaction
  - The tax would be assessed on, and collected from, financial firms
- United Kingdom, France, Switzerland, Taiwan and Hong Kong already have a similar tax

BIDEN Tax Proposals
Business Interest Expense Deduction

- Businesses generally have been able to deduct business interest
- As part of trade off to lower the corporate rate, TCJA added new section 163(j) to prevent interest deductions in excess of 30% of "adjusted taxable income" (ATI)
- Before 2022 ATI was a proxy for EBITDA
- In 2022, depreciation, amortization and depletion will be included to reduce ATI
  - Impact: Reduces amount of deductible business interest

BIDEN Tax Proposals
Estate and Gift Tax: A Moving Target

	Pre-TCJA (before 12/31/2017)	TCJA (current through 12/31/2025)	TCJA After Sunset (1/1/2026)	Biden Proposal
Estate, Gift and GST Tax Exemption	$5.49 million per individual, inflation indexed	$11.7 million per individual, inflation indexed	$5.49 million, inflation indexed	$3.5 million per individual at death; potentially $1 million lifetime gift tax exemption
Step-Up in Basis for Inherited Property	Yes	Yes	Yes	No
Estate, Gift and GST Tax Rates	40%	40%	40%	45%

BIDEN Tax Proposals
Possible Retroactivity

- Possible, but unlikely: changes to estate and gift tax could be made retroactive to January 1, 2021
- More likely: changes effective as of date of enactment, or prospectively
- Taxpayers wishing to avoid tax at all costs might consider building in flexibility in case of retroactivity:
  – "QTIP-able" trusts - Formula valuation clauses
  – Disclaimer trusts - Net Gift Agreements

BIDEN Tax Proposals
Repeal of Basis Step-Up on Inherited Assets

- Current law:
  - Cost basis of assets in a decedent's estate are "stepped up" to the date of death value
  - Assets transferred during lifetime retain donor's cost basis ("carryover basis")
- Biden administration has proposed eliminating the step-up in basis at death
  - Assets retain their original cost basis from decedent's acquisition, subject to exemption
  - Not clear whether death will be a "mark to market" event causing capital gains tax to be due

BIDEN Tax Proposals
Other Potential Estate/Gift Tax Changes

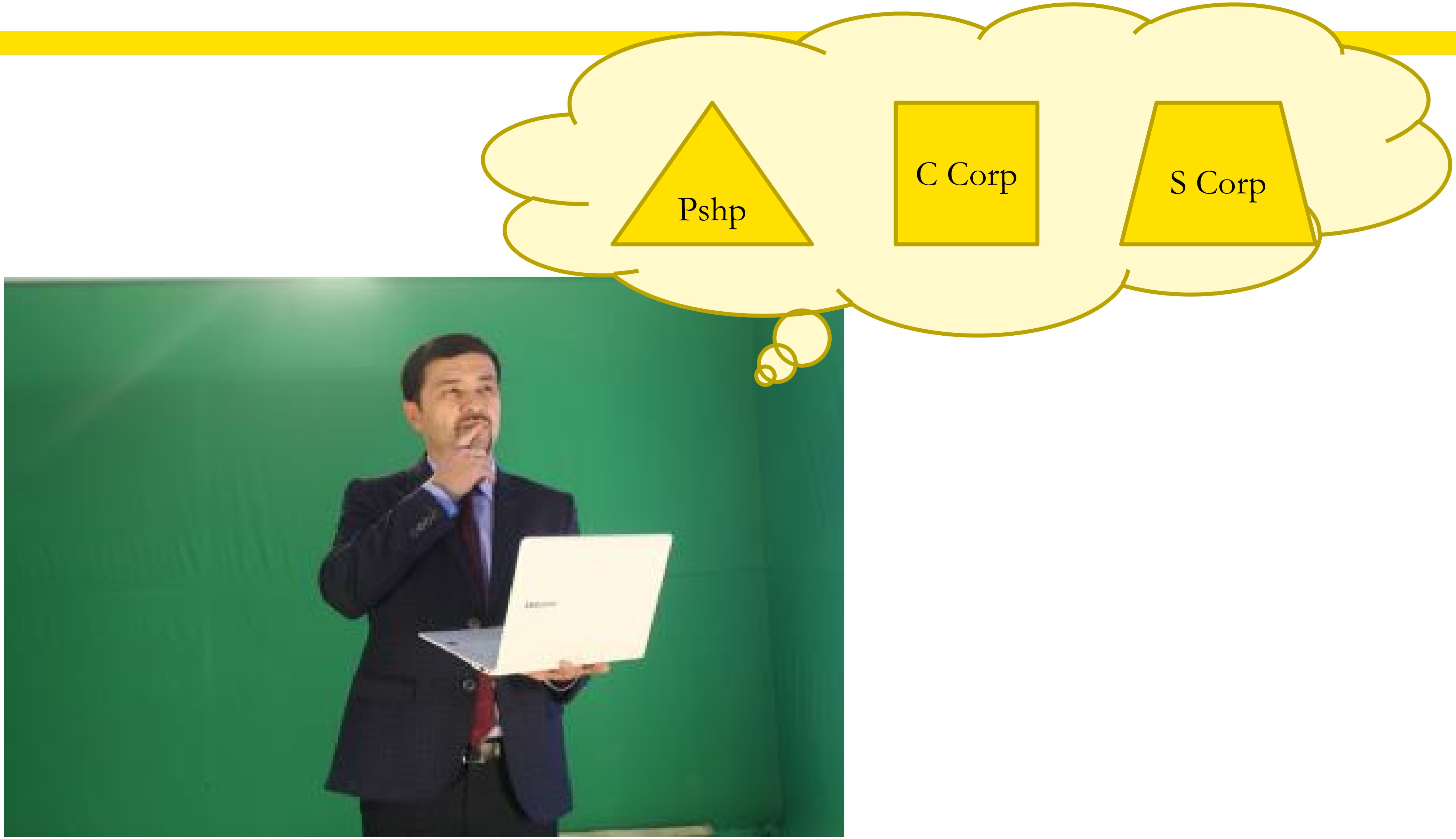
- New restrictions making GRATs less favorable
  - Potential 10-year minimum term
  - Potential minimum taxable gift at 25% of amount transferred
- Limitation on use of sales to "intentionally defective grantor trusts"
- Reduction or elimination of valuation discounts on family-controlled entities

Warren Tax Proposal
Ultra-Millionaire Tax Act

- Introduced March 1, 2021 by Elizabeth Warren et al.
- Tax would be on 100,000 wealthiest U.S. households:
  - 2% annual tax on net worth of households and trusts between $50 million and $1 billion
  - 1% annual surtax (3% tax overall) on net worth of households and trusts above $1 billion
- Anti-evasion measures
  - $100 billion investment in IRS
  - 30% minimum audit rate on taxpayers subject to wealth tax
  - 40% exit tax on taxpayers renouncing citizenship

Choice of Entity

Choice of Entity



Choice of Entity
Entity Comparisons

Entity Type	Income Passes Thru	Owners providing services	Profits Interests & Different Classes	Property Contributions
Partnership (or LLC taxed as partnership)	Yes	Self-employment tax applies	Yes	721
Disregarded Entity (e.g., SMLLC)	Yes	Self-employment tax applies	N/A	N/A
S Corp	Yes	Part salary, part shareholder distribution	No	351
C Corp (or LLC taxed as C corp)	No – Double Taxation	Part salary, part 301 dividend	No profits interests, but different classes of stock can be issued.	351

Choice of Entity
Entity Comparisons

Entity Type	Interestholder Basis for Debt	199A	In-kind distributions	Liquidation
Partnership (or LLC taxed as partnership)	Yes	Yes	731 – generally not taxable	736 – generally not taxable
Disregarded Entity (e.g., SMLLC)	N/A	Yes	Non-event	Non-event
S Corp	No	Yes	311(b) – corp recognizes gain	331
C Corp (or LLC taxed as C corp)	No	No	311(b) – corp recognizes gain	331/332 (for 80% subsidiaries)

Choice of Entity
Entity Comparisons

Entity Type	Gain on Interest Sale	QSBS	338(h)(10)
Partnership (or LLC taxed as partnership)	Capital gain, subject to 751*	No	N/A
Disregarded Entity (e.g., SMLLC)	Treated as sale of underlying assets*	No	N/A
S Corp	Capital	No	Yes
C Corp (or LLC taxed as C corp)	Capital	Yes	Only for consolidated sub

*Note application of Rev. Rul. 99-5 and Rev. Rul. 99-6 where interest sales/purchases cause shift between multi-member/partnership and single-member/DRE

Choice of Entity
Partnership

- 721 property contributions
- Pass-through of income
- Debt basis
  - Leveraged distributions
- QBI deduction
  - Sunset

Choice of Entity
Partnership

- Carried Interests
  - TCJA and carried interest regulations
  - Impact of capital gain rate changes
- Application of 751
- 731 applies on liquidation

Choice of Entity
C Corporation

- 21% current rate
- 28% under proposal
- Reminder to also consider state tax rate differentials
- Possible availability of QSBS exclusion

Choice of Entity
C Corporation

- 351 - Non-recognition on property contributions requires contributors to have control after

  opportunity to trigger gain by violating control requirement

- 311(b) taxes gain on in-kind distributions

  opportunity to trigger gain

Choice of Entity
C Corporation

- 331 taxable liquidations vs. 332 tax-free liquidations
  - 80% sub threshold
  - *Granite Trust Co. v. U.S.*, 238 F2d 670 (1st Cir. 1956)

  opportunity to trigger gain
- Note liquidation-reincorporation doctrine.
  - A liquidation which is followed by a transfer to another corporation of all or part of the assets… may have the effect of the distribution of a dividend or of a transaction in which no loss is recognized and gain is recognized only to the extent of "other property."
  - Treas. Reg. 1.331-1(c)

Choice of Entity
S corporation

- Restrictions
  - Single class of shares
  - 100 shareholder cap
  - No foreign owners, and generally no regarded entities as owners
- Self-employment tax savings
- Pass-through taxation
- 199A may apply
  - Sunset
- No debt basis

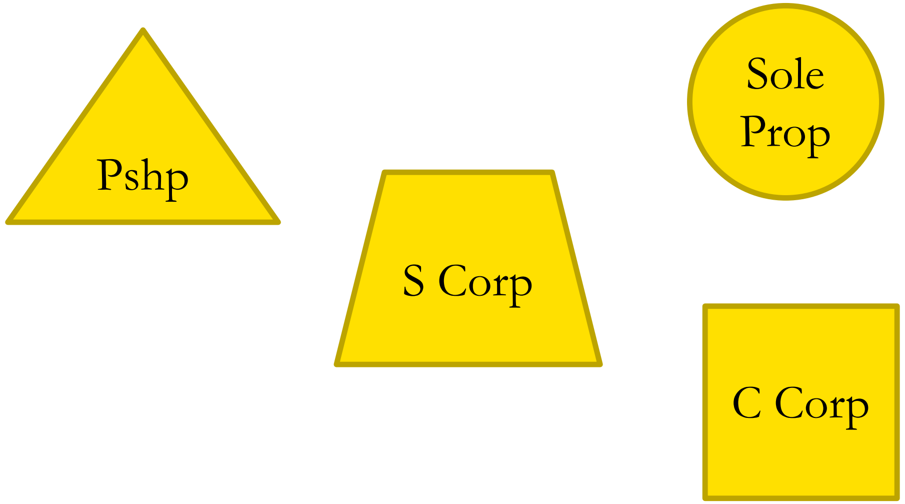
Choice of Entity
S corporation

- 351 generally applies to contributions if control requirement is met
- 311(b) taxes gain on in-kind distributions

  ***opportunity to trigger gain ***
- 331 liquidation

  *** opportunity to trigger gain ***
- 338(h)(10)
  - Impact of capital gains rate change

Choice of Entity
Limited Liability Companies



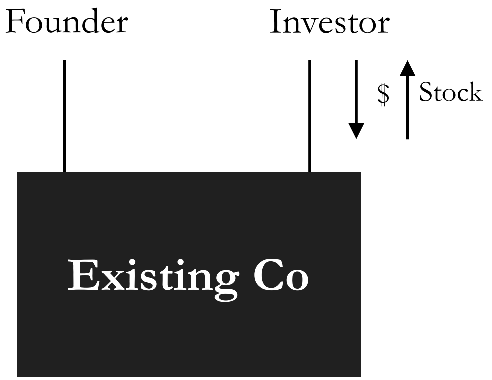
- Flexibility
- Check-the-box regulations
- Deemed incorporations and liquidations
- But note limit on frequency of changes
  - After electing to change classification, no subsequent change by election for 60 months.
  - Election effective on the date of formation is not considered a change.
  - Treas. Reg. 301.7701-3(c)(1)(iv)
- Note also liquidation-reincorporation doctrine

Choice of Entity
QSBS – Qualified Small Business Stock

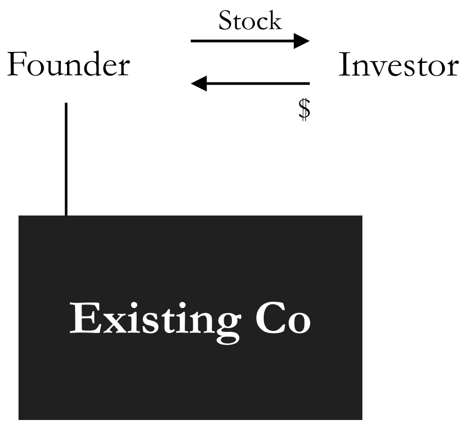
- Allows for up to 10x investment in a C Corp to be returned free of federal tax if it is held for 5 years and §1202 requirements are met.
- Generally applies to investments into a "C" corporation that has less than $50MM in basis in its assets.
  - Not in a prohibited service business
  - No significant redemptions of shareholder stock

Choice of Entity
QSBS – Structures Generally

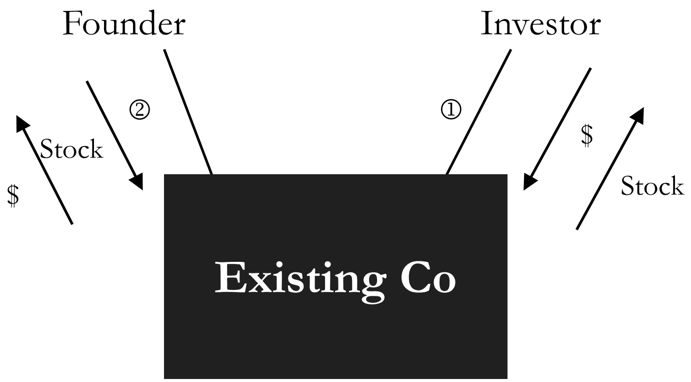
Intent of QSBS



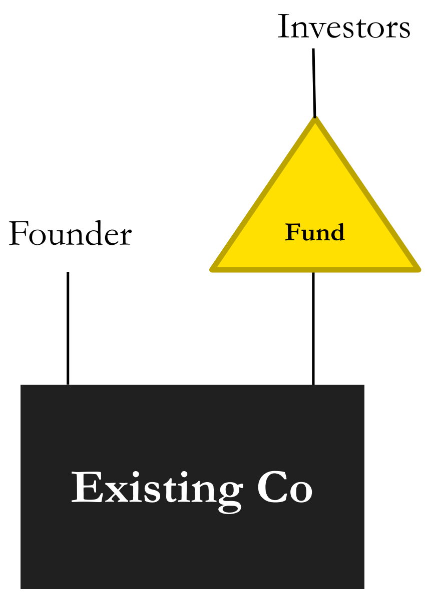
Not Allowed



Generally Not Allowed



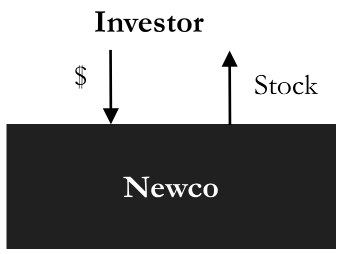
Choice of Entity
QSBS – Ownership Through a Flow-Through Vehicle



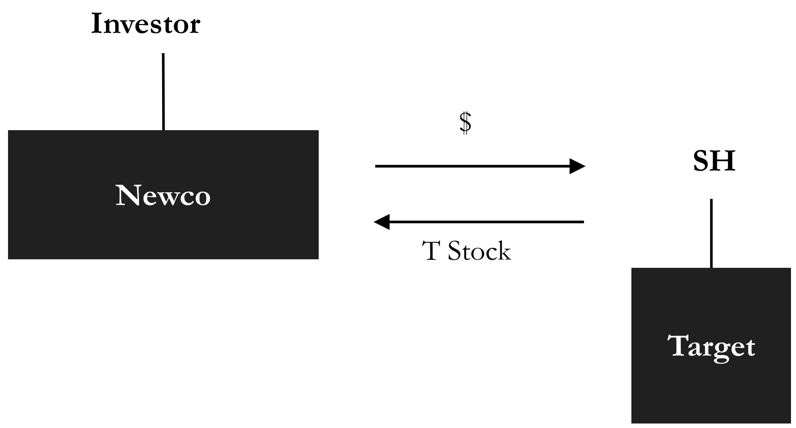
- QSBS benefits pass through flow through entities provided:
  - All other §1202 requirements are met.
  - The stock is held by the entity for more than 5 years.
  - The owner of the entity held its interest in the entity on the date the entity acquired the QSBS.

Choice of Entity
QSBS – Current Trends

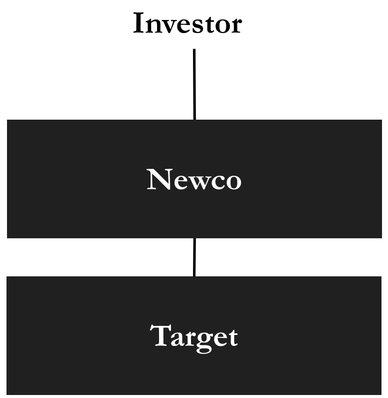
Step 1



Step 2



Final Structure



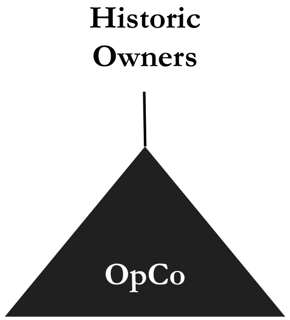
If investor contributes more than $50MM to Newco, does this structure satisfy the $50MM gross asset test?

Choice of Entity
Up-C Considerations

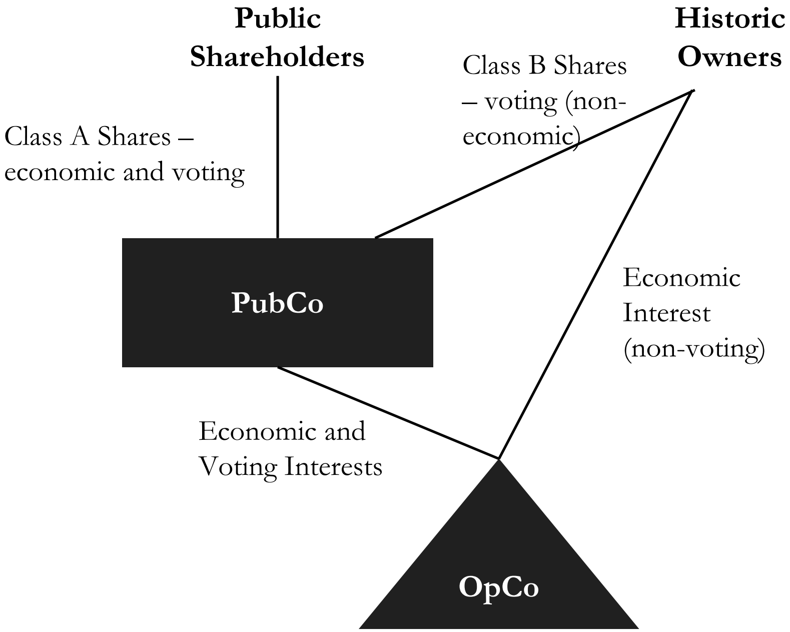
- Up-C structure allows owners of an existing flow-through entity (the "Historic Owners") to continue to be subject to 1 layer of tax, while allowing the business to raise capital through a corporation.
  - When raising money from public markets, this avoids the PTP rules.

Choice of Entity
Up-C Structure

Initial Structure



Up-C Structure



Choice of Entity
Up-C Benefits

- Access to capital
- Liquidity for Historic Owners
- Avoid entity-level tax on earnings to Historic Owners
- Historic Owners get benefit of Pubco's tax basis step-up through a tax receivable agreement (TRA).

Choice of Entity
Up-C Considerations

- Historic Owners are granted rights to exchange partnership interests and Class B shares for cash or Class A shares.
  - Exchange is taxable and PubCo may get a basis step-up in the OpCo's assets through a 734(b) or 743(b) adjustment.
- Through TRA, PubCo generally agrees to pay Historic Owners a majority (often 85%) of the value associated with the tax savings.

Remote Work Tax Issues

State and Local Tax Issues Related to the new World of Remote Work and Hybrid Work Arrangements

State and Local Employment Taxes – General Principles

- One employee who works in a state generally is sufficient to create nexus with a state for employment tax purposes
- Some question as to whether an employee who works at home once in a while is sufficient, but not really doubt that a regular home office in a state allows a state to require withholding
  - May depend on what the worker(s) is/are doing

General Principles – State/Local Income Taxes

- Generally, residents of a state are subject to tax on income from worldwide sources
  - Credit rules can vary, especially for local taxes, but states must offer credits for taxes paid to other states on the same income
- Nonresidents, however, typically are subject to tax only on income earned in a state

General Principles – State/Local Income Taxes

- Employee A – Works in State 1; lives in State 2
  - Employer withholds State 1's income tax and remits it to State 1;
  - Employee A files a return in State 2 claiming a credit for the tax withheld by his or her employer against tax owed to State 2
    - May owe additional tax to State 2, **but**
    - No refund for amounts paid to State 1

General Principles – State/Local Income Taxes

- Reciprocity –
  - Designed to eliminate some of the headaches caused by the default rules;
  - Allows employers to essentially ignore work location and to withhold tax based on where employees live
    - Only by agreement of the states
    - **Not** typically applicable to any local taxes

Multi-State Workforces –
Pre- and (Post-?) COVID Remote Work

- In a perfect world, employers would be able to determine where an employee works every day (hour?) and would withhold tax accordingly
- In practice, many short-term reassignments are ignored
  – Some states have de minimis rules, but many do not
  – Technically, most de minimis rules are applicable only to employers, not employees

Multi-State Workforces – Pre- and (Post-?) COVID Remote Work

- Most employers apply a reasonableness test
  - *I.e.*, Is an employee working in State 1 for a reasonable enough period of time that we will treat State 1 as a regular work location of the employee?
    - May require compliance with state employment laws and other state-level taxes/fees/contributions
      - *E.g.*, Unemployment taxes, Workers' Comp
      - Rules vary by state

Multi-State Workforces –
Pre- and (Post-?) COVID Remote Work

- Convenience of the employer doctrine
  - Many states take the position that employees who regularly work in a location are still working there, even if they are working remotely, unless the remote work is for the convenience of the employer
  - Makes sense when employee stays home to wait for a repair person, to stay with a sick family member, etc.
  - But: could there be Constitutional problems with that approach applied to long-term arrangements?

COVID - Nexus Guidance of Many States

- Employment Tax Nexus
  - Employee who typically works in State 1 and is working remotely outside of State 1
    - Still State 1 source income
  - Employee who typically works outside of State 1 and is working remotely in State 1
    - Presumably still **not** State 1-source income to employee and no withholding by employer
  - Only an issue with respect to states without reciprocity
- Presence Ignored for Corporate Tax Nexus

Post-COVID Landscape

- No “one-size-fits-all” approach
- Bad news for employers/good news for state and local tax lawyers – every state law (where employees are located) needs to be considered
- Requires working with payroll services/internal systems to determine what even is possible

Post-COVID Landscape

- Employers generally should start by presuming that they will – at least – be required to withhold tax in all states where employees work regularly
- May require setting up new accounts, etc.
- It’s also advisable to work on some type of system to “know” where employees are working

Post-COVID Landscape

- Expect the Convenience of the Employer Doctrine to cause special headaches
  - If every jurisdiction were to only require withholding when employees work from such location, the rules (at least would be clear)
  - But Convenience of the Employer rules could cause concerns related to double taxation

Post-COVID Landscape

- Example of possible headaches: Philadelphia and PA local taxes
  - Philadelphia likely will argue that compensation is subject to tax when paid for services performed by an employee who *could* come to the office in the City
  - However, when such an employee regularly works from home, his/her home jursidction likely will assert tax is due

Other Tax Issues

- Nexus is not limited to employment taxes
  - Presence likely will cause an employer to have nexus for other state tax purposes
    - Income Taxes
    - Sales Tax Collection
    - Other, “special” taxes
      - Washington State B&O Tax

Special Problems – Bonuses and Deferred Comp

- Many states (and localities) have types of lookback rules
  - Comp earned in Year 1 (including bonuses) paid in Year 2 may be taxable based on where the employee worked in Year 1 (even though that may no longer be the employee's work location).
- Can employers even track this?

What Should Employers Do?

- Start with what is possible – internal systems/payroll providers, etc.
- Establish **written** policies regarding expectations of where employees will be while working
- Follow the written policies

What Should Employers Do?

- What should such policies consider?
  - Clear delineation of days in/out of the office
  - Are employees *required* to work from a location?
    - Convenience of the Employer doctrine
    - Vaccination status?
  - Can employees track work locations/will employees be required to report travel (and under what circumstances)?

What Should Employers Do?

- Not just an employment tax issue
  - Policies should take into account other tax issues
  - HR and Tax departments must work together to make sure policies make sense and required information is available

Thank you for your time!