NCSL SALT Task Force Meeting
Charleston, South Carolina
November 22, 2019

2020 Legislative Initiatives to Improve State Tax Compliance & Administration

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Three Important 2020 Initiatives to Improve State Tax Administration:

- Improve Reporting of Federal Tax Adjustments to the State:
  - General improvements to the process
  - Specific improvements related to new federal partnership audit rules

- Provide Original and Extended State Tax Return Due Dates One Month After Federal Due Dates

- Enact 30-Day Threshold before non-residents are subject to (and if applicable local) income taxes – with reciprocity
Improve Reporting of Federal Adjustments to the State
Background

- Bipartisan Budget Act of 2015 imposed new IRS Audit Procedures for partnerships and multi-member LLCs
  - Projected 10-year $9.3 billion revenue-raiser (federal alone)
- States incorporate the IRC “tax base” in their laws; however, state assessment/refund laws are separate from that of the IRC
  - Almost every state that imposes an individual and/or corporate income tax has to update their federal adjustment reporting laws to account for the new federal audit procedures
- Unique opportunity to improve overall process for taxpayers to report changes to the states (and, as applicable, local governments)
- General improvements needed for all taxpayers:
  - Clear definition of Final Determination based on all issues for a tax year being resolved at the federal level
  - Provide all taxpayers with at least 180 days to report (interest still accrues under tax laws)
  - Absent a waiver, limit changes after the state’s general statute of limitations and taxpayer to federal changes
  - Equal and clearly stated assessment/refund periods
Background Continued

- COST, AICPA, and other tax associations worked with the MTC to model legislation for reporting federal changes for all taxpayers, and identified the issues with taxpayers reporting adjustments under the new partnership audit regime

- Specific issues addressed in the MTC Model for partnership audits:
  - Adopts federal partnership representative procedure, allowing for a partnership to choose a different state partnership representative
  - Allows election at federal level to differ at the state level
  - Addresses apportionment/allocation issues for partnerships to pay tax, if not need to consider
  - Importantly, tiered partnership structures (partnerships owning other partnerships) are covered

- With federal audits likely starting in 2019/2020, states need to consider conforming to the MTC Model ASAP
States Adopting MTC Model Partner Audit Act

As of October 9, 2019

- States that have enacted legislation
- States that have enacted legislation, but need to more closely follow MTC Model
- States that potentially need legislation

Source:
Provide Original and Extended State Tax Return Due Dates and One Month After Federal Due Date.
Why an Additional Month is Needed for State Tax Returns

State Return Completion Follows Federal Determination of Taxable Income

Let’s face it – a taxpayer cannot generally file its state income tax return until it calculates its federal income tax liability. This is especially true for multijurisdictional businesses, to calculate a state’s apportionment of income, tax credits, etc.

- In general, federal returns are filed at, or very near, the extended due date, and because the state returns often are also extended, additional time is needed to submit a complete and accurate state return. TCJA implementation has only increased taxpayers timely filing returns.

- State filing deadline an additional month after federal filing provides time for taxpayers and practitioners to accurately calculate apportionment.

- The legislation would ensure that the state has:
  - State tax return due dates at least one month after the federal tax return due date.
  - State tax return due dates automatically extended with the granting of a federal extension.
  - An automatic state extension that only requires attaching a copy of the federal extension with the state return.

- Without a one-month extension, taxpayers may need to file state returns using estimates and then file amended returns, increasing compliance burdens for taxpayers, tax preparers, and tax administrators.

- Changing the filing deadline should not affect the tax payment deadline, and therefore, should have a minimal state administration effect.
Suggested Legislation

A state’s law should **automatically provide that the state return original and extended due dates are the federal due dates** (e.g., May 15, 2020 and November 16, 2020 for 2019 calendar year returns); or, at least one month after the original and extended due dates for a taxpayer’s federal income tax return.

As applicable, **interest and penalties for late payment of the tax may still apply** (unless taxpayer complies with estimated payment requirements).

Model Legislation –

1) For tax years beginning on or after January 1, 2019, calendar year and fiscal year [taxpayer] returns shall be filed no later than one month after the due date established under the Federal Internal Revenue Code, including any extensions granted by the Internal Revenue Service.

2) No penalty due to late filing shall be incurred by a taxpayer granted a federal extension if its state return is filed no later than one month after the period of time specified in the Federal extension. The [taxpayer] does not request [revenue director] for an extension of time within which to file the taxpayer’s state return.
States that Potentially Need Legislative One-Month Filing Extension

- Potentially impacted states for corporations and non-corporations
- * Denotes a state’s corporate income tax is not impacted

Sources: AICPA and COST
Enact 30-Day Threshold Before Non-Resident Subject to State (And If Applicable Local) Taxes – With Reciprocity Provision
Background on Issues with States’ Lack of Uniform Taxation when Taxing Non-Residents

States have widely varied and inconsistent requirements for:
• Employees to file personal income tax returns when traveling to a nonresident state for temporary periods
• Employers to withhold income tax on employees who travel outside of their state residency periods
• Unnecessary Tax Swap & Burden with income tax credits provided by employee’s resident states

U.S. House has passed legislation, “Mobile Workforce State Income Tax Simplification Act,” that passed the 115th Congress, but the U.S. Senate has not moved it – present bills for 116th Congress are H.R. 4796 &

As a result of inaction, move to state-by-state enactment effort

General Description of Model State Model Legislation:
• Employees earning wages/compensation not subject to tax unless in a non-resident state if exceed limit, all earnings subject to tax from first day in the state
• Similar bills – exclusions for professional athletes, entertainers, speakers, and if applicable, employees
• To encourage other states to adopt – it is suggested the states have a reciprocity provision, safe harbor based on another state having a similar law
When is a nonresident employer subject to withholding?

Important note: These don’t necessarily align with an employee’s filing requirement.

Please note that this map only covers withholding. Many states have different standards for imposing tax on nonresidents (that is, the employee may owe tax even where the employer is not required to withhold). The map does not include reciprocal agreements. Also note that 21 states provide exemptions for nonresidents performing
States that Should Consider Legislation a 30-Day Threshold

- **Impacted**: states potentially lacking a clear minimum 30-day threshold for personal income tax imposition for non-resident workers.
- **Resolved**: Illinois enacted 30-day threshold for tax years 2020; Arizona and Hawaii both have 60-day thresholds.

Source: COST
Questions?

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