



# IMPACT OF TCJA ON STATE TAXATION

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# OPTIONS CONSIDERED OR ADOPTED



Reclassify certain state tax payments as charitable contributions

Create employer-based payroll taxes

Enact entity-level tax for PTEs

File legal challenge against Federal government

Enact comprehensive state tax reform

# STATE LEGISLATIVE APPROACHES TO SALT WORKAROUNDS - CHARITABLE



- Charitable deduction in exchange for state tax credits
  - Provide a state tax credit for charitable contributions to a state created public purpose fund, with donation qualifying as federally tax deductible.
  - Enacted:
    - New York
    - New Jersey
    - Oregon
  - Considered:
    - California
    - Illinois
    - Rhode Island



# CHARITABLE DEDUCTION AND STATE TAX CREDITS – IRS GUIDANCE



- IRS guidance: [IR-2018-122](#) and [Notice 2018-54](#)
  - IRS issued on May 23, 2018
  - Promised proposed regulations to be issued to address the relationship between federal charitable contribution deductions and the new statutory limitation on the deduction of state and local taxes



# CHARITABLE DEDUCTION AND STATE TAX CREDITS – IRS GUIDANCE



- IRS Proposed Regulations (issued 8/23/18) (REG 112176-18)
- Transfers to a state agency or charitable organization in lieu of paying state and local taxes deductible as charitable contribution only to extent taxpayer making the donation did not receive a quid pro quo



# BUSINESS TAXPAYERS DEDUCTION PROTECTED



- [IR-2018-178](#) (IRS issued 9/5/18)
  - Clarified business taxpayers receive full contribution amount as a fully deductible business expense
  - Taxpayers who make business-related payments to charities or government entities in exchange for state or local tax credits can generally deduct the payments as business expenses as long as the payment qualifies as an ordinary and necessary business expense
  - The general deductibility rule is unaffected by REG-112176-18



# STATE LEGISLATIVE APPROACHES TO SALT WORKAROUNDS – PAYROLL TAX



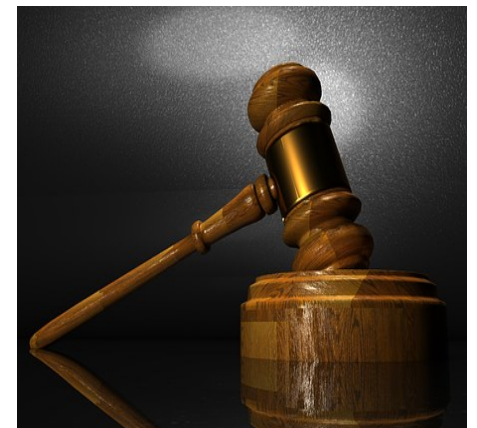
- Switch payroll taxpayer from employee to employer. Employer can deduct without limitation.
- Ex. New York (optional) Employer Compensation Expense Tax
  - Low enrollment (< 0.1% of state's employers)



# STATE LEGISLATIVE APPROACHES TO SALT WORKAROUNDS - LAWSUIT



- Legal challenge against Federal government
  - CT, MD, NJ, NY filed complaint 7/17/18 in US District Court in Manhattan
  - To void new \$10,000 cap on Federal deduction for state taxes paid
  - Accuses federal government of unconstitutionally intruding on state sovereignty by imposing the cap. By imposing cap, Congress was able to “exert a power akin to undue influence” over states by interfering with their authority to decide taxes & fiscal policy
  - Cap will depress home prices, spending, job creation, and economic growth and impede ability to pay for essential services (schools, hospitals, police, road and bridge construction and maintenance)
  - Says \$10,000 cap “effectively eviscerates” a deduction that has been available since 1861
  - Defendants are Dept. of Treasury, Sec. of Treasury, and IRS
  - [New York et al. v. Mnuchin, et al.](#), U.S. District Court, Southern District of NY, No. 18-06427



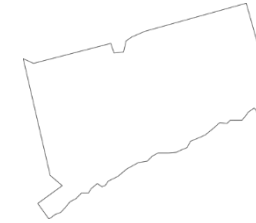


# PASS-THROUGH ENTITY (PTE) TAX

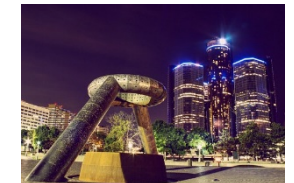


- Shifts state tax on business income from owners to entity
- Allows entity to federally deduct as an expense from business income the entity's state income taxes paid in carrying on a trade or business
- Owners receive a credit against state personal income tax for their distributive or pro rata share of the state entity tax paid at entity level
  - Applies to S corporations, partnerships, and limited liability companies taxed federally as partnerships or S corporations

# PASS-THROUGH ENTITY (PTE) TAX



- Connecticut enacted [Public Act 18-49](#) 5/31/18, effective 1/1/18
  - 6.99% entity-level income tax on most PTEs in Connecticut (mandatory)
  - Owners' credit against their CT personal income tax for 93.01% of their distributive or pro rata share of the PTE-level tax paid
  - CT Guidance on estimated payments ([SN 2018\(4\)](#), 6/6/18), the calculation ([OCG-6](#), 6/19/18, and the owner credit ([OCG-7](#), 8/21/18)
- Wisconsin enacted [Public Act 368](#)
  - Created an optional tax on pass-through entities with an offsetting exclusion for entity members
  - Also created a link between *Wayfair*-related revenue and personal income tax rates
  - Part of the legal challenge by the incoming Governor
- Other states considering it
  - Michigan – SB 1170 (passed Senate unanimously)
  - New York – [Discussion draft](#) for unincorporated Business Tax (May 2018)
    - (Not in Governor's FY 2020 Budget)
  - Arkansas – draft bill before Tax Reform and Relief Legislative Task Force
  - Minnesota – SF 304 was introduced January 22, would allow pass-throughs to elect to be treated as C Corporations and pay a flat tax at the entity level.



# PASS-THROUGH ENTITY TAX – POTENTIAL CONCERNS



- IRS view uncertain
- No expiration date (unlike TCJA-sunset after 2025)
- Risk of double taxation
- Differences in Sourcing Rules (income to PTEs v. individuals)
- Treatment of unreimbursed business expenses



# WHITHER *WAYFAIR*?

- Recent Sales and Use Tax Developments
  - *Wayfair* overturned the long-standing physical presence requirement for sales and use taxes
  - Many states have enacted, or are considering, marketplace bills imposing collection requirements on marketplaces
- If states see increased revenue from the effects of these developments, will they change their personal income and/or sales and use tax rates, as Wisconsin did?