

Domestic and Multistate Tax Update

39th Annual TEI-SJSU High Tech Tax Institute
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Agenda

1. **Domestic Income Tax Update** (not covered elsewhere in program)
2. **California Update**
3. **Multistate**
 - Major Tax Legislation
 - State Response to IRC §174
 - Significant State Tax Litigation in 2023
4. **Questions**

1. Domestic Income Tax Update

(not covered elsewhere at this conference)

3

Updated Form 3115 and Instructions (Dec. 2022) – Ann. 2023-12 (4/7/23)

- Form 3115 does not include a year, updated periodically rather than annually.
- Form changes seem minor
- What's new per instructions:

What's New

Changes related to the deferral method for advance payments, cost offset methods, and/or the applicable financial statement income inclusion rule. The instructions for Schedule B have been updated to include additional information about accounting method changes relating to the deferral method for advance payments, cost offset methods, and methods to conform to the applicable financial statement (AFS) income inclusion rule under section 451.

Research and experimental expenditures. Effective for specified research or experimental expenditures paid or incurred in tax years beginning after 2021, no deduction is allowed for such expenditures. Instead, you must capitalize and amortize these amounts over a 5-year period for amounts attributable to domestic research and over a 15-year period for amounts attributable to foreign research. See DCN 265 and Rev. Proc. 2023-11, 2023-3 I.R.B. 417.

- <https://www.irs.gov/forms-pubs/about-form-3115>

4

IRS Updates List of Automatic Method Changes – Rev. Proc. 2023-24 (6/15/23)

- 462 pages
 - Helpful table of contents to find if your change is listed.
 - Pages 444 – 455 list the 29 significant changes made from Rev. Proc. 2022-14.
 - Last 6 pages are contact list if have question about particular changes.
- Supersedes most of Rev. Proc. 2022-14 but not all (see page 440).
- <https://www.irs.gov/pub/irs-drop/rp-23-24.pdf>

5

IRS Practice Units on Accounting Methods (1/17/23)

2 topics:

- Identifying and Handling Claims for Changes in Accounting Methods
- Accounting Method Basics
- <https://www.irs.gov/businesses/corporations/practice-units>

6

Deferred Comp of Sold Business Not Deductible – *Hoops*, No. 11308-18 (7th Cir., 8/9/23), aff'g [TC Memo 2022-9](#)

- 2000 - H formed to acquire, own and operate an NBA team
 - 2001 – acquired Vancouver Grizzlies and moved them to Memphis, TN
- 2012 – IRS disallowed \$10.7 million of salaries and wages claimed on H's 1065X for deferred comp liabilities of 2 players assumed by buyer of substantially all of H's assets in 2012.
 - \$10.7 million is total of \$12,640,000 discounted 3%
 - H uses accrual method
 - Issue: Is H entitled to (1) deduction for the comp, or (2) offset to amount realized (\$1231 gain) from sale of assets?
 - H filed return using (1). Later amended return to use (2) because no deduction was claimed on 2012 return for the comp, following Reg. 1.461-4(d)(5).
 - IRS disallowed the deduction.

7

Hoops – Tax Court

- Deferred comp governed by §404(a).
 - Generally deductible when recipient reports as income.
- (1) H argues that per §461(h) economic performance rule can deduct.
 - Tax Court – No. §404 then limits the deduction to year paid and included in recipient's income. Reg. 1.461-1(a)(2) – how taken into account - must also consider other relevant rules.
 - Doesn't violate clear reflection of income because Congress provided §404(a)(5) to deviate from that, in order to match timing of deduction and income among payor and payee for deferred comp.
- (2) §1001 – Gain realized includes assumed liabilities
 - H – but only if H got a deduction for that liability
 - Tax Court – H relieved of liability in sale, so include in amount realized
 - H argued should get deduction in year of sale as if constructively paid the liability to buyer
 - “by accepting less cash than the seller otherwise would have received had it retained the liability, it effectively made a constructive payment to the buyer to satisfy the liability.” *James M. Pierce Corp*, 326 F2d 67 (8th Cir. 1964)

8

Hoops – 7th Circuit

- Accrual method rules different for deferred comp per §404 – no deduction until comp actually paid and included in income of employees.
- Buyer’s assumption of deferred comp liability allow a deduction as if paid?
- Hoops: Reg. § 1.461-4(d)(5)(i) allows deduction:
 - “If, in connection with the sale or exchange of a trade or business by a taxpayer, the purchaser expressly assumes a liability arising out of the trade or business that the taxpayer **but for the economic performance requirement** would have been entitled to incur as of the date of the sale, economic performance with respect to that liability occurs as the amount of the liability is properly included in the amount realized on the transaction by the taxpayer.” [emphasis added]
- 7th Circuit: Deductions are matter of legislative grace and here §404(a)(5) not satisfied to allow a deduction as comp wasn’t paid.
 - It is not just economic performance requirement that hasn’t been met as comp has not been paid yet.
 - Also, reg can’t prevail over statute.

9

Hoops – 7th Circuit

- 7th Circuit finds Hoops’ “practical implications” of decision of no relevance:
 - While H can claim deduction when players paid, they note that buyer may fail to tell them they were paid or might not pay them.
 - Per court, this is a problem H could have avoided such as by:
 - Adjusting sales price to reflect deductibility
 - Contributing to qualified plans for earlier deductions.
 - Renegotiation contracts with players to accelerate their comp to the date of sale and paying that comp.

<https://media.ca7.uscourts.gov/cgi-bin/OpinionsWeb/processWebInputExternal.pl?Submit=Display&Path=Y2023/D08-09/C:22-2012:J:Scudder:aut:T:fnOp:N:3086884:S:0>

10

Third Circuit Upholds Tax Court That Legal Fees Related to Generic Drug Development Currently Deductible – *Mylan Inc. & Subs.*, Nos. 22-1193, 21-1194, 22-1195 (3rd Cir., 7/27/23)

- Like lower court case, includes lengthy description of Hatch-Waxman act on generic drugs
 - Congress: “attempted to balance the goal of making available more low cost generic drugs with the value of patent monopolies in incentivizing beneficial pharmaceutical advancement.”
 - Gives branded drug company “opportunity to vindicate their patent rights” but that plays no role in FDA’s review of the ANDA
- “It has long been the rule that taxpayers may deduct the costs of defending one’s business against a tort because mounting such a defense is an ordinary business response.”
 - Such claims are generally torts and limitation costs of defendants in patent infringement suits generally are deductible rather than capitalizable.
 - And also deductible by patent holder as protecting their income.
- <https://www2.ca3.uscourts.gov/opinarch/221193p.pdf>

11

Mylan Inc. & Subs., Nos. 22-1193, 21-1194, 22-1195 (3rd Cir., 7/27/23) - continued

- “we hold today that it makes no difference in deciding the question of deductibility whether the patent litigation expenses are incurred by the patentee or the alleged infringer”
 - Reg. 1.263(a)-4 – when to capitalize costs to create or acquire intangible assets or to facilitate such creation or acquisition.
 - “In promulgating capitalization regulations and providing examples, IRS emphasized that, consistent with “current law” and specifically in light of our decision in *Urquhart*, 215 F.2d 17, the rules are “not intended to require capitalization of amounts paid to protect ... property against infringement.” [preamble to 2002 regs]
 - Prior to regs, IRS had allowed deduction for ANDA litigation expenses.
- 3rd Circuit, like lower court found that litigation expenses don’t affect getting FDA approval so don’t facilitate creation or acquisition. Generic drug company can also market its generic drug “under the cloud of patent litigation” if have FDA approval.

12

Mylan Inc. & Subs., Nos. 22-1193, 21-1194, 22-1195 (3rd Cir., 7/27/23) - continued

- IRS argument that certain Hatch-Waxman provisions connect the approval and litigation found to be incorrect.
- “ultimate FDA approval is never decided by the outcome of patent litigation under § 271(e)(2), even if it is delayed by such litigation. That the Hatch-Waxman Act affects when suit can be brought is noteworthy but certainly not determinative.”
- Act doesn’t “transform ordinary patent infringement litigation into a facilitating step for generic drug approval.”

13

New Form 7205 for 2022 for §179D Deductions

- Not noted in “What’s New” on Form 1120 for 2022 but is noted in instructions for “other deductions” to now use new form 7205 to claim energy efficient commercial buildings deduction.
- Per instructions, seems will continue past 2022 with IRA 2022 changes to be included after 2022 form.

<p>Form 7205 <small>December 2022</small> Department of the Treasury Internal Revenue Service</p>	<p>Energy Efficient Commercial Buildings Deduction</p> <p>Attach to your tax return.</p> <p>Go to www.irs.gov/Form7205 for instructions and the latest information.</p>	<p>OMB No. 1545-2004</p>
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What’s New

Form 7205 is a new form that is used to claim the deduction for energy efficient commercial building property placed in service before January 1, 2023. Taxpayers with a short tax year beginning in 2023 and ending in 2023 that place qualifying property in service during this period, see [Who Must File](#) below.

<https://www.irs.gov/forms-pubs/about-form-7205>

14

Crypto Donations Valued at More than \$5,000 and Appraisal Requirement – CCA 202302012 (1/13/23)

- Facts: Individual (T) prepares own return and claims deduction of \$10,000 for Cryptocurrency B donated to charity. Reported on Form 8283. Value obtained from a listing of B on a cryptocurrency exchange. T argues appraisal not needed because B has a “readily ascertainable value” shown on exchange.
- Law:
 - IRS notes §6045(g) defining digital asset, Notice 2014-21 and Rev Rul. 2019-24, AND §170(f)(11), Reg. 1.170A-13, 1.170A-16 and 1.170A-17, and related case law.
- <https://www.irs.gov/pub/irs-wd/202302012.pdf>

15

Review of §170(f)(11) on Qualified Appraisals

- §170(f)(11) Qualified Appraisal and Other Documentation for Certain Contributions
 - (A) In general
 - (i) Denial of deduction In the case of an individual, partnership, or corporation, no deduction shall be allowed under subsection (a) for any contribution of property for which a deduction of more than \$500 is claimed unless such person meets the requirements of subparagraphs (B), (C), and (D), as the case may be, with respect to such contribution.
 - (ii) **Exceptions**
 - (I) **Readily valued property** Subparagraphs (C) and (D) shall not apply to cash, property described in subsection (e)(1)(B)(iii) or section 1221(a)(1), publicly traded securities (as defined in section 6050L(a)(2)(B)), and any qualified vehicle described in paragraph (12)(A)(ii) for which an acknowledgement under paragraph (12)(B)(iii) is provided.
 - (II) **Reasonable cause** Clause (i) shall not apply if it is shown that the failure to meet such requirements is due to reasonable cause and not to willful neglect. ...
 - (C) **Qualified appraisal for contributions of more than \$5,000** In the case of contributions of property for which a deduction of more than \$5,000 is claimed, the requirements of this subparagraph are met if the individual, partnership, or corporation obtains a qualified appraisal of such property and attaches to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require.

16

Crypto Donations Valued at More than \$5,000 and Appraisal Requirement – CCA 202302012 (1/13/23) – HOLDING 1

- If claim deduction over \$5,000 for contribution of cryptocurrency, must have qualified appraisal per §170(f)(11).
 - Exception for publicly traded securities uses §165(g) definition of “security”.
 - Crypto B is not a security.
 - **Qualified appraisal needed.**

17

Crypto Donations Valued at More than \$5,000 and Appraisal Requirement – CCA 202302012 (1/13/23) – HOLDING 2

- **If appraisal required and donor fails to get one, reasonable cause exception at §170(f)(11)(A)(ii)(II) does not apply.**
 - Must have exercised “ordinary business care”.
 - Form 8283 says qualified appraisal needed. So, even if had paid preparer, T has no reasonable cause.
 - See *Pankratz*, TC Memo 2021-26. Tax Court noted that 4 mentions of “appraisal” on Form 8283 “is pretty good notice that substantial noncash donations need to be backed up by an appraisal.””
 - “The reasonable cause exception was not intended to provide taxpayers with the choice of whether to obtain a qualified appraisal, but to provide relief where an unsuccessful attempt was made in good faith to comply with requirements of section 170. ... As such, claims that B has a readily ascertainable value because it is listed on a cryptocurrency exchange does not establish reasonable cause for failing to obtain, or attempting to obtain, a qualified appraisal.”

18

Digital Asset Question Added to Draft 1120 (line 327), 1065 (line 30) and 1120S (line 16) for 2023 (6/22 & 23/2023)

Form 1065 (2023)

Page **4**

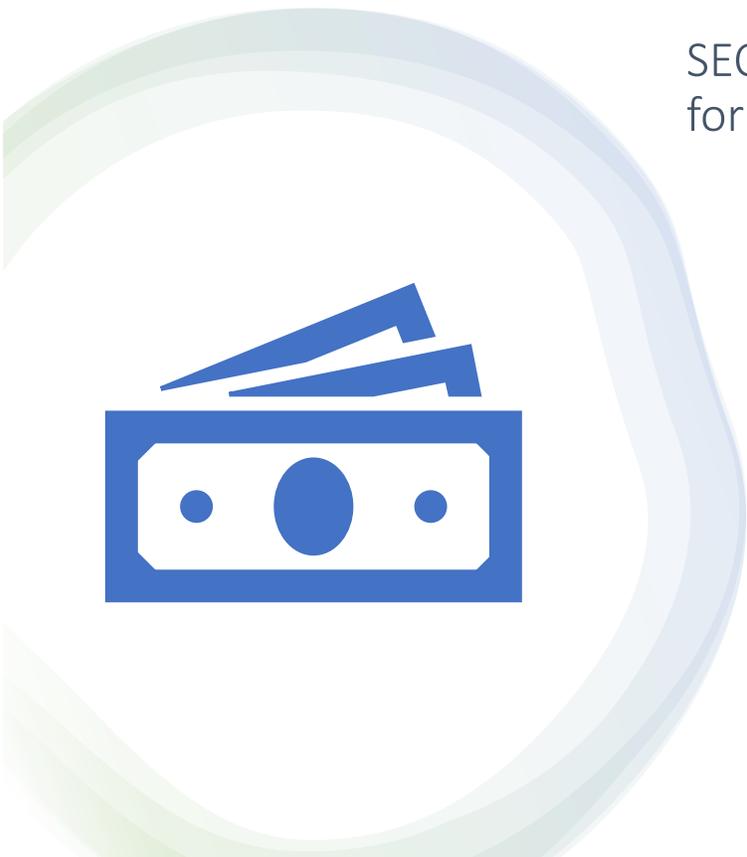
Schedule B Other Information (continued)		Yes	No
b	Under the covered surrogate foreign corporation rules? If "Yes" to either (a) or (b), complete Form 7208, Excise Tax on Repurchase of Corporate Stock. See the Instructions for Form 7208.		
30	At any time during this tax year, did the partnership (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or financial interest in a digital asset)? See instructions		

Form 1120-S (2023)

Page **3**

Schedule B Other Information (see instructions) (continued)		Yes	No
12	During the tax year, did the corporation have any non-shareholder debt that was canceled, was forgiven, or had the terms modified so as to reduce the principal amount of the debt? If "Yes," enter the amount of principal reduction \$		
13	During the tax year, was a qualified subchapter S subsidiary election terminated or revoked? If "Yes," see instructions		
14a	Did the corporation make any payments in 2023 that would require it to file Form(s) 1099?		
b	If "Yes," did or will the corporation file required Form(s) 1099?		
15	Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund? If "Yes," enter the amount from Form 8996, line 15 \$		
16	At any time during the tax year, did the corporation: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? See instructions		

19



SECURE Act 2.0 Reminder for 2024 for Student Loan Repayments

- SEC. 110, Treatment of student loan payments as elective deferrals for purposes of matching contributions
 - Adds §§401(m)(4)(iii), 401(m)(4)(D) and 401(m)(13), and related items
- Allows employees to use employer 401(k) match program to have plan contribution from employer for employee's payment on student loan.
- Per Section-by-Section analysis of SECURE 2.0
 - "Section 110 is intended to assist employees who may not be able to save for retirement because they are overwhelmed with student debt, and thus are missing out on available matching contributions for retirement plans. Section 110 allows such employees to receive those matching contributions by reason of repaying their student loans. Section 110 **permits an employer** to make matching contributions under a 401(k) plan, 403(b) plan, or SIMPLE IRA with respect to "qualified student loan payments." A qualified student loan payment is broadly defined as any indebtedness incurred by the employee solely to pay qualified higher education expenses of the employee. Governmental employers are also permitted to make matching contributions in a section 457(b) plan or another plan with respect to such repayments. For purposes of the nondiscrimination test applicable to elective contributions, Section 110 permits a plan to test separately the employees who receive matching contributions on student loan repayments. Section 110 is effective for contributions made for plan years beginning after December 31, 2023."

20

ERC and Supply Chain Disruption – AM 2023-005 (7/21/23)

- Clarifies CARES Act Sec. 2301(c)(2) and IRC §3134(c)(2)(A)(ii) as not including supply chain disruptions.
- Notice 2021-20 – includes narrow exception for employers that had to fully or partially suspend business operations because their supplier of critical goods or materials was fully or partially suspended due to gov't orders.
- Includes 5 examples.
 - Next slide – Example 1
- <https://www.irs.gov/pub/iraoa/am-2023-005-508v.pdf>

21

ERC and Supply Chain Disruption – AM 2023-005 (7/21/23)

- Scenario 1 – Employer A not subject to gov't orders that limit commerce, travel or group meetings at any time.
 - 2020 and 2021 – experience delays in receiving critical goods from Supplier 1.
 - But kept operating because had surplus of the goods.
 - A assumed supplier's delay was due to Covid but supplier did not provide gov't order and A unable to find one.
- Holding: A is not eligible employer.
 - Can't show that gov't order applicable to supplier fully or partially suspended supplier's operations.
 - EVEN if A had supplier's order, A did not have to cease operations due to its surplus.
- “relevant inquiry is whether Employer A's trade or business operations could continue; since Employer A was able to continue its own business operations despite the supply chain disruption, it was not subject to a full or partial suspension of operations.”

22

IRS Stops NEW ERC Claims Processing – IR-2023-169 (9/14/23)

- **Headline:** “To protect taxpayers from scams, IRS orders immediate stop to new Employee Retention Credit processing amid surge of questionable claims; concerns from tax pros”
- Processing stopped immediately through end of 2023.
 - “to protect honest small business owners from scams”
- “IRS developing new initiatives to help businesses who found themselves victims of aggressive promoters. This includes settlement program for repayments for those who received improper ERC payment; more details available this fall.”
- Also coming – special withdrawal option for claims not yet processed and taxpayer realizes were scammed
- IRS working with Dept. of Justice to pursue fraud including ERC promoters.
- <https://www.irs.gov/newsroom/to-protect-taxpayers-from-scams-irs-orders-immediate-stop-to-new-employee-retention-credit-processing-amid-surge-of-questionable-claims-concerns-from-tax-pros>

23

Pre-Proposed Regs Info on §4501 Stock Buyback Excise Tax – Notice 2023-2 (12/27/22)

Outline of Sections

1. Overview (pages 1 – 2)
 - Notice provides rules and procedures (such as how to pay), that will be in future proposed regs.
2. Background (pages 2 – 8)
 - Mostly summary of §4501
3. Interim guidance regarding application of §4510 (pages 8 - 46)
 - Includes examples
4. Reporting and payment of stock repurchase excise tax (pages 46 – 47)
5. Applicability dates (page 47)
6. Request for Comments (pages 47 – 52)
7. Drafting and contact information (page 52)

<https://www.irs.gov/pub/irs-drop/n-23-02.pdf>

24

Transition Guidance for §4501 Corporate Stock Buyback Excise Tax – Ann. 2023-18 (6/29/23)

- Excise tax isn't owed for any tax year prior to time specified in forthcoming regs.
- Tax added by IRA 2022 effective for 2023.
- Notice 2023-2 (12/27/22) presented pre-reg guidance.
- At 6/29/23 – no proposed regs yet
- <https://www.irs.gov/pub/irs-drop/a-23-18.pdf>

25

2024 ESRP Amounts under §4980H – Rev Proc. 2023-17 (3/9/23)

- ACA penalties applicable to applicable large employer (with 50 or more full-time and FTE in prior year) for not offering required coverage to FT employees and their dependents up to age 26
- Announces penalty amounts for 2024:
 - §4980H(a) \$2,970
 - §4980H(b)(1) \$4,460
- **Observation:** First time since this penalty effective (started 2014) that IRS announced updated amounts in an IRB ruling. Prior year amounts noted in FAQ 55.
 - <https://www.irs.gov/affordable-care-act/employers/questions-and-answers-on-employer-shared-responsibility-provisions-under-the-affordable-care-act>
 - See past amounts and penalty reminders on next slides.

<https://www.irs.gov/pub/irs-drop/rp-23-17.pdf>

26

Review: When could applicable large employer be subject to §4980H(a) or (b)(1) penalty?

- §4980H(a) - If does not offer minimum essential coverage to at least 95% of its full-time employees and their dependents up to age 26, AND at least one FT employee claims PTC.
 - \$2,000 adjusted for a factor after 2014
 - First 30 employees excluded from penalty calculation but applies to rest of FT employees even if only one claimed PTC.
- §4980H(b)(1) – Does offer coverage to at least 95% of FT employees and their dependents, but it is either not minimum value or affordable.
 - \$3,000 adjusted for a factor after 2014
 - Only applies for FT employees who claimed PTC.
- Both only apply for months where employer did not comply.

27

§4980H(a) or (b)(1) penalty since 2014

Year	§4980H(a)	§4980H(b)(1)
2014	\$2,000	\$3,000
2015	\$2,080	\$3,120
2016	\$2,160	\$3,240
2017	\$2,260	\$3,390
2018	\$2,320	\$3,480
2019	\$2,500	\$3,750
2020	\$2,570	\$3,860
2021	\$2,700	\$4,060
2022	\$2,750	\$4,120
2023	\$2,880	\$4,320
2024	\$2,970	\$4,460

28

“Clean Vehicle” Definition Comparisons Per §30D(d)

§30D(d) defining clean vehicle Note: Also see §25E and §45W for requirements unique to these provisions.	§30D, Clean Vehicle Credit	§25E, Previously-Owned Clean Vehicle	§45W, Commercial Clean Vehicle
(d)(1)(A) Original use commences with taxpayer	Yes	No	No
(d)(1)(B) acquired for use or lease by taxpayer and not for resale	Yes	No	Yes
(d)(1)(C) made by qualified manufacturer (see (d)(3))	Yes	Yes	Yes
(d)(1)(D) treated as motor vehicle ((d)(2)) per title II of Clean Air Act	Yes	Yes	Yes, limited exception
(d)(1)(E) gross vehicle weight rating of less than 14,000 pounds	Yes	Yes	
(d)(1)(F) propelled to significant extent by electric motor drawing electricity from battery with capacity of at least 7 kilowatt hours(see (d)(4)) and capable of recharge from external source of electricity	Yes	Yes	Yes (15 kilowatt if 14,000 pounds or more) or fuel cell option
(d)(1)(G) assembled in North America (see (d)(5))	Yes	No	No
(d)(1)(H) buyer must get report from seller (see details at (H) & Rev. Proc. 2022-42	Yes	Yes (other than (H)(iv))	No. Manufacturer reports to IRS.
(d)(6) special rule for new qualified fuel cell motor vehicle	Yes	Yes (used)	See 45W(c)(3)
(d)(7) foreign entity of concern limit for vehicles placed in service after 2023	Yes	No	No

29

Vehicle Credit Comparisons - More

	§30D, Clean Vehicle Credit	§25E, Previously-Owned Clean Vehicle	§45W, Commercial Clean Vehicle
MAGI limitation?	For individuals, not for businesses	Yes	No
MSRP limitation	Yes	No, but sales price limit	No
Critical minerals and battery component requirements?	Yes	No	No
Original use by buyer	Yes	No	Not required
Transfer of credit to dealer possible §30D(g) for vehicles placed in service after 12/31/23	Yes	Yes	No
Expires for any vehicle acquired after 12/31/32	Yes	Yes	Yes

30

IRS Websites for IRA Created or Modified Vehicle Credits

§30D, Clean
Vehicle Credit

- <https://www.irs.gov/credits-deductions/credits-for-new-clean-vehicles-purchased-in-2023-or-after>

§45W, Credit
for Qualified
Commercial
Clean Vehicle

- <https://www.irs.gov/credits-deductions/commercial-clean-vehicle-credit>

All IRA credits
and deductions

- <https://www.irs.gov/credits-and-deductions-under-the-inflation-reduction-act-of-2022>

31

OPR – In-house Tax Professionals and Circular 230 (Issue 2023-04; 6/15/23)

- OPR addresses these questions (with brief answer provided; see link for details):
 1. *Are in-house tax professionals subject to Circular 230?*
 - Yes if attorney, CPA or attorney + limited practice rules of C230
 2. *Do in-house practitioners “practice before the Internal Revenue Service”?*
 - Yes if “practice before the IRS”.
 3. *If an in-house tax professional does not hold an up-to-date certificate or license (as a lawyer, CPA, or EA), can they still engage in practice before the IRS?*
 - Generally yes under “limited practice?”
- <https://content.govdelivery.com/accounts/USIRS/bulletins/3601863>

OPR – In-house Tax Professionals and Circular 230 (Issue 2023-04; 6/15/23) - continued

4. *Must all in-house tax professionals who work on a company's tax matters and interact with IRS personnel be listed on a Form 2848, Power of Attorney and Declaration of Representative?*
 - To designate a specific individual, use Form 2848.
 - If only presenting information, no 2848 needed; Form 4764, Communications Agreement, will suffice.
5. *Given their dual roles as advisor/representative and decision-maker/implementer, are there times when an in-house tax professional is a "practitioner" and other times when they are not?*
 - "There is no authority or basis, however, for concluding that an activity constituting "practice" for an outside professional does not also constitute "practice" for an in-house one. Thus, while an in-house tax professional's relationship with their employer — who is also the client/taxpayer — is different from the relationship that an outside professional has with the same client/taxpayer, **except in the possible case of an officer appointed by the board of directors, the in-house professional never becomes the client/taxpayer itself. They — like an outside practitioner — are always acting as an agent, or representative, of the taxpayer.**"

33

President's FY2024 Greenbook (3/9/23)

- \$4.7 trillion revenue raisers less \$731 billion outlay
 - Net \$4 trillion revenue increase over 10 years
- Categories of tax changes: [specifics on following slides]
 - Reform business taxation
 - Reform international taxation
 - Support housing and urban development
 - Modify energy taxes
 - Strengthen taxation of high-income taxpayers
 - Modify rules related to retirement plans
 - Support workers, families, and economic security
 - Modify estate and gift taxation
 - Close loopholes
 - Improve tax administration
 - Improve tax compliance
 - Modernize rules, including for digital assets
 - Improve benefits tax administration
 - Extend IRS funding

34

Ways and Means Tax Proposals in June

3 bills under “American Families and Jobs Act”

- H.R. 3936, Tax Cuts for Working Families Act
- H.R. 3937, Small Business Jobs Act
- H.R. 3938, Build It in America Act

- **Observation:** Primarily large tax cuts with largest offset for repeal of some energy credits.

Links to bills and summaries: <https://waysandmeans.house.gov/smith-introduces-the-american-families-and-jobs-act-to-cut-taxes-for-working-families-grow-main-street-businesses-and-protect-american-innovation-competitiveness/>

35

Ways and Means Tax Proposal – H.R. 3936, Tax Cuts for Working Families Act

- Rename standard deduction as “guaranteed deduction”
- Bonus Guaranteed Deduction for 2024 and 2025
 - MFJ \$4000
 - Head-of-Household \$3,000
 - Single \$2,000

 - Limited to:
 - MFJ \$400,000
 - HH \$300,000
 - S \$200,000

- 6/13/23 – passed by Ways and Means Committee

36

Ways and Means Tax Proposal – H.R. 3937, Small Business Jobs Act

- Increases §6041 contractor and §6041A reporting thresholds from \$600 to \$5,000; adjust for inflation.
 - Rationale: has been \$600 since 1954
 - **Observation:** increases tax gap.
- Repeal §6050W TPSO \$600 threshold
- Increase §179 deduction to \$2.5 million
- Changes to §1202 including reducing holding period to over 3 years (rather than over 5) but exclusion is only 50% at 3 years, 75% at 4 and 100% at 5 or more + expand to S corp shareholders
- Establishment of rural opportunity zones
- 6/13/23 – passed by House Ways and Means
- JCT Revenue Estimate
 - Loss of \$81 billion 2023-2033
 - <https://www.jct.gov/publications/2023/jcx-27-23/>

37

Ways and Means Tax Proposals – H.R. 3938, Build It in America Act

- Restore expensing of §179 R&D for tyba 12/31/21
- Restore §163(j) interest threshold to pre-2022 formula
- Restore 100% bonus depreciation starting 2023
- Termination of hazardous substance superfund financing rate
- Election to determine foreign income taxes paid or incurred to certain Western Hemisphere countries without regard to certain regs
- Excise tax on purchase of farmland by citizens of countries of concern
- Repeal some IRA 2022 energy credits
 - Clean electricity production credit (§45Y)
 - Clean electricity investment credit (§48E)
 - Credit for previously used clean vehicle (§25E)
 - Credit for commercial clean vehicle (§45W)
- Modifications to 30D Clean Vehicle Credit

38

H.R. 3938, Build It in America Act – §30D, Clean Vehicle Credit Changes

- Reverts to pre-IRA 2022 formula for credit
 - Base amount of EV credit is \$2,500 and credit increased by \$417 for each kilowatt-hour of battery capacity in excess of 4 kilowatt-hours.
 - Max credit is \$7,500
- Keeps IRA 2022 MAGI and MSRP limits
- Keeps modified critical mineral and battery component requirements
- Restores the 200,000 vehicle manufacturer threshold and phasedown over once that threshold is met.

39

Ways and Means Tax Proposals - H.R. 3938, Build It in America Act – JCT Revenue Estimate

<https://www.jct.gov/publications/2023/jcx-29-23/>

Provision	Revenue Estimate (\$millions) 2023-2033
Deduction for research and experimental expenditures (sunset 12/31/25)	-25,385
Extension of allowance for depreciation, amortization, or depletion in determining the limitation on business interest (sunset 12/31/25)	-18,948
Extension of 100 percent bonus depreciation (sunset ppisa 12/31/22 & 12/31/25)	-3,046
Termination of Hazardous Substance Superfund financing rate and repayable advance authority	10,506
Election to determine foreign income taxes paid or accrued to certain Western Hemisphere countries without regard to certain regulations	-1,346
Imposition of tax on acquisition of US agricultural interests by disqualified persons	--
Repeal of clean electricity production credit (§45Y; no change to §45)	25,166
Repeal of clean electricity investment credit (§48E; no change to §48)	90,529
Modification of clean vehicle credit	99,698
Repeal of credits for previously—owned clean vehicles and commercial clean vehicles	741
TOTAL	\$156,903

Federal Tax Regulations and IRS Rulings

Two pdf files posted:

1. Federal tax regs issued in 2023
2. All revenue rulings, revenue procedures and notices published in IRB in 2023

- <https://www.sjsu.edu/people/annette.nellen/website/2023regs.html>



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41

2. California Update

OTA Holds Deductible Income Included in Sales Factor

- In *Minnesota Beet Sugar Cooperative* (No.19034447, March 17,2023 – released Aug.2023) the Office of Tax Appeals held that deductible income received from a unitary group member must be included in the sales factor calculation.
- OTA declined to follow a 2006 legal ruling issued by the California Franchise Tax Board holding that certain deductible items that do not factor into taxable net income should be excluded from the sales factor.

43

Summary Judgement Challenging FTB's Guidance on PL 86-272 Denied

- In *American Catalog Mailers Association v. Franchise Tax Board*, the California Superior Court denied a motion for summary judgement in an action challenging the FTB's guidance interpreting PL 86-272.
- In 2022 FTB released TAM No.2022-01 and revised Pub 1050 addressing internet transactions, including several examples.
- ACMA challenged two specific hypothetical examples:
 - Provision of live chat and email through website
 - Placing internet cookies on computers of CA customers
- The Court could not conclude as a matter of law that the use of generic hypotheticals in the guidance contradicts PL 86-272 on its face such that the entire TAM and Publication 1050 are invalid.

44

Permanent Marketplace Sales Regulation Issued

- Effective Aug 28, 2023, the CDTFA promulgated a permanent sales tax regulation to provide guidance for marketplace sales.
 - 2019 legislation established sales tax collection and remittance requirements for marketplace facilitators.
 - Emergency regulation became operative June 29, 2020.
- The permanent regulation generally retains the language of the emergency regulation, with some noteworthy changes:
 - While the broad definition of “marketplace facilitator” is included in the permanent regulation, new definitions are added for “fulfillment or storage service,” “order taking,” and “providing customer service or accepting or assisting with returns or exchanges.”
 - Numerous definitions are amended and expanded, including the definition of “facilitate,” “branding sales as those of the marketplace facilitator,” “listing products for sale,” and “payment processing services.”
 - For purposes of determining whether a marketplace seller is a retailer engaged in business in CA because its sales delivered in the state exceed \$500,000, the regulation is amended to clarify that all sales of tangible property for delivery in the state are considered, regardless of whether the sales are taxable.

45

3. Multistate Update

- Major Tax Legislation
- State Responses to IRC §174 Changes
- Significant State Tax Litigation in 2023

Major tax legislation

Massachusetts

- On Oct. 4, 2023 Massachusetts enacted H.B. 4104, which includes significant changes expected to reduce taxes by approximately \$1B, representing Massachusetts' first tax cuts in more than 20 years.
- Effective Jan. 1, 2025, Massachusetts broadly adopts single-sales factor apportionment.
 - Existing law applies a three-factor apportionment formula with a double weighted sales factor, except for certain industries (manufacturing, defense, and mutual services).
- H.B. 4104 also amends the provision for financial institutions to adopt a single sales factor method effective Jan. 1, 2025.
 - The changes modify the special sourcing provisions for financial institutions that apply to the interest, dividends, net gains, and other income from investment and trading assets and activities.

47

Major tax legislation

New Jersey

- On July 3, 2023, NJ enacted major tax legislation, A.B. 5323, which makes significant changes to the Corporation Business Tax (CBT) regime
- For privilege periods ending on and after July 31, 2022
 - Changes to net deferred tax liability deduction for combined groups
 - Worldwide combined group must include all members of the combined group, wherever located or formed
 - Interest deduction limitation under IRC Sec. 163(j) is applied to a combined group as though the combined group filed a federal consolidated return
- For taxable years beginning in 2023 and thereafter, a taxpayer subject to Gross income tax that engages in a trade or business, or is an owner of a partnership or S corporation, which conducts business within and outside NJ must use CBT sourcing provisions if the income from NJ sources cannot be readily or accurately ascertained

48

Major tax legislation

New Jersey

- For privilege periods ending on and after July 31, 2023:
 - Bright-line nexus standard for CBT purposes – Corporation deriving receipts from sources within NJ is deemed to have substantial nexus and is subject to CBT if it meets either criteria during its fiscal or calendar year: (i) derives receipts from sources within NJ in excess of \$100,000; or (ii) has 200 more separate transactions delivered to customers in NJ
 - Treatment of GILTI and FDII changed – GILTI is treated in the same manner as other dividend income; 100% of FDII is subject to CBT
 - Apportionment factor for unitary combined groups adopts *Finnigan* method
 - Changes to NOLs and prior NOL conversion carryovers
 - Certain captive REITs, RICs, and investment companies are included in combined groups and taxed in same manner as C corporations
 - Related-party addback repealed

49

Major tax legislation

Minnesota

- On May 24, 2023, MN enacted an omnibus tax bill, H.F. 1938, containing several new and increased taxes on businesses and individuals
- For taxable years beginning after Dec. 31, 2022
 - Taxpayers are required to include GILTI as dividend income
 - Dividend received deduction is reduced from (i) 80% to 50% if the recipient owns 20% or more of the stock; and (ii) 70% to 40% if the recipient owns less than 20% of the stock
 - Corporation NOL deduction limitation is reduced from 80% to 70%
- For taxable years beginning in 2024 and thereafter, the legislation imposes a 1% tax on the net investment income of individuals, trusts, and estates that exceeds \$1 million
- Effective July 1, 2024, the omnibus transportation bill, H.F. 2887, enacts a 50 cent delivery fee on deliveries of certain taxable tangible personal property and clothing, when delivered to a person in MN as part of a retail sale exceeding \$100

50

Major tax legislation

Tennessee

- For corporate excise tax purposes, TN is phasing from a three-factor apportionment formula with a triple-weighted sales factor to a single sales factor over a three-year period beginning with tax years ending on or after Dec. 31, 2023 (H.B. 323/S.B. 275)
- For assets purchased on or after Jan. 1, 2023, TN adopts the current federal bonus depreciation provisions as amended by the Tax Cuts and Jobs Act (TCJA)
 - For property placed in service after 2022, 100% federal bonus depreciation is being phased out in 20% increments, with a complete elimination of bonus depreciation beginning in 2027
 - TN historically has decoupled from federal bonus depreciation – continues to be disallowed for assets purchased on or before Dec. 31, 2022
- Credit carryforward periods for several excise and franchise tax credits are extended from 15 years to 25 years
- Effective July 1, 2024, following the lead of several other states, the legislation adds new statutes to provide rules for sourcing transactions for sales and use tax purposes

51

Major tax legislation

Corporate income tax rates

- In AR, for tax years beginning on or after Jan. 1, 2023, the highest corporate income tax rate is reduced from 5.3% to 5.1% (S.B. 549)
- CT extended the 10% corporation business tax surcharge for three additional years through the 2025 tax year (H.B. 6941)
- KS reduced the corporate income tax rate from 4% to 3.5% effective Jan. 1, 2024, but continues to impose a 3% surtax on KS taxable income over \$50,000 (Notice of Corporate Income Tax Normal Rate Reduction, Aug.31.2023)
- NE enacted legislation to further reduce the corporate income tax rate for tax years beginning on or after Jan. 1, 2024 (L.B. 754)
 - For tax years beginning on or after Jan. 1, 2025, tax rate on the first \$100,000 of taxable income is eliminated and one rate will apply to all taxable corporate income
 - The rate gradually is reduced until it reaches 3.99% for tax years beginning on or after Jan. 1, 2027

52

Major tax legislation

Corporate income tax rates

- NJ decided not to extend its 2.5% corporate surtax on income over \$1 million beyond Dec. 31, 2023
- NYS enacted budget legislation extending its increased corporate income tax rate of 7.25% for any taxpayer with NYS apportioned income for the tax year of more than \$5 million (A.B. 3009/S.B. 4009)
 - Extended for three years through the 2026 tax year
 - The 7.25% rate applies to all income subject to tax if the \$5 million apportioned income base is exceeded
- In NYS, the 0.1875% tax rate on the capital base is extended for three years through the 2026 tax year (A.B. 3009/S.B. 4009)
- UT reduced its corporate income tax rate from 4.85% to 4.65% for tax years beginning on or after Jan. 1, 2023 (H.B. 54)

53

Major tax legislation

Corporate income tax rates

- Iowa rate will drop from 8.4% to 7.1% for tax years beginning on or after Jan. 1, 2024.
 - Pursuant to H.F.2317 enacted in 2022, the rates are being reduced because FY23 revenues exceeded thresholds needed to reduction authorization.
 - 2024 is 2nd consecutive year of rate reductions.

54

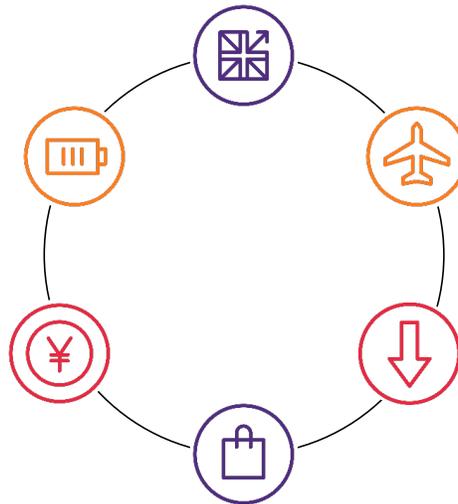
Major tax legislation

Apportionment: Throwback and throwout

- For tax years beginning on or after Jan. 1, 2024, AR is phasing out the throwback rule until it is completely eliminated for tax years beginning on or after Jan. 1, 2030 (H.B. 1045)
 - During the phase-out period, sales of tangible personal property are partially sourced to AR if the property is shipped from AR and the taxpayer is not taxable in the state of the purchaser
 - For tax years beginning in 2024, 6/7 of such sales are sourced to AR and 1/7 of such sales are sourced outside the state
 - Each year, the portion of such sales sourced to AR is reduced by 1/7, until the throwback rule is eliminated for tax years beginning in 2030
- For tax years beginning on or after Jan. 1, 2024, LA is repealing its throwout rule (H.B. 631)

55

State responses to federal changes to IRC §174



56

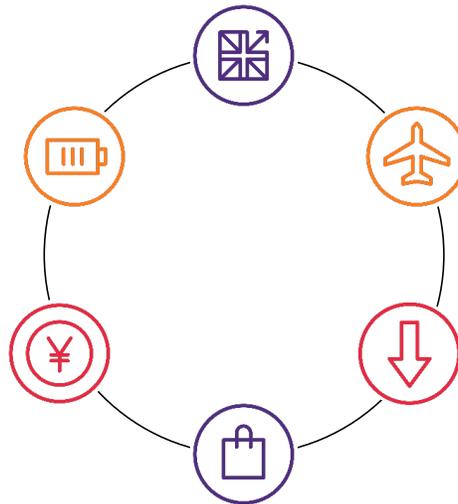
State responses to federal changes to IRC Sec. 174

Some states deciding to decouple

- Under IRC Sec. 174, prior to enactment of the TCJA, taxpayers were allowed the option to currently deduct research and experimental (R&E) expenditures or treat such expenditures as deferred expenses to be capitalized and amortized over their life
- As amended by the TCJA, for amounts paid or incurred in tax years beginning in 2022 and thereafter, all taxpayers are required to capitalize R&E expenditures over a five-year period for domestic expenses and 15 years for foreign expenses
- During the first half of 2023, **GA, IN, MS** and **NJ** enacted legislation decoupling from IRC Sec. 174 and allowing the R&E expenditures to be deducted in the year in which they are incurred

57

Significant state tax litigation in 2023



58

Significant state tax litigation in 2023

Income tax:

- Market-based sourcing litigation in Pennsylvania and Florida

Indirect taxes:

- Maryland Digital Advertising Tax litigation: tax invalidated in state court, case dismissed in federal court

Other taxes/unclaimed property:

- Washington capital gains tax upheld by state supreme court
- The *MoneyGram* case and impact on unclaimed property

59

Income tax litigation

Synthes USA HQ, Inc. v. Commonwealth (Pa. Feb. 2023)

- PA Supreme Court upheld a Pennsylvania Department of Revenue policy sourcing sales of services to the location where the benefit is received under pre-2014 rules
 - Pennsylvania-based corporation sourced sales to Pennsylvania using a traditional cost-of-performance rules
 - Taxpayer sought a refund by recalculating its sales using benefits-received rules, based on the PA Department of Revenue's interpretation of the sourcing statute
 - Taxpayer lost at the administrative level for insufficient evidence
- At Commonwealth Court, Department took the position that sales are sourced using benefits-received rules – PA Attorney General's office took a contrary position that sales are sourced using traditional cost-of-performance rules
- PA Supreme Court sided with the taxpayer/the Department reasoning the pre-2014 statute was ambiguous and the Department's policy interpretation controlled
 - Court ordered that the taxpayer receive a refund

60

Income tax litigation

Florida cost-of-performance sourcing cases

- *Target Enterprise v. Fla. Department of Revenue* (Fla. Circuit Ct. Nov. 2022):
 - Florida circuit court ruled that a taxpayer’s use of the cost-of-performance (COP) method to source service revenue for FL corporation income tax purposes was **correct**
 - Taxpayer earned revenue from a retail operating services agreement with its corporate parent – sourced service revenue outside FL based on vast majority of payroll costs being incurred outside the state
 - Circuit court sided with taxpayer on the COP method used, rejecting DOR’s alternative apportionment method, which relied on the corporate parent’s business activity
- *Billmatrix Corp. v. Fla. Department of Revenue* (Fla. Circuit Ct. Mar. 2023):
 - Florida circuit court held that FL law required the use of the COP method to source taxpayers’ service revenues for FL sales factor purposes
 - Taxpayers provided financial technology services from locations outside FL and incurred majority of costs to perform services outside the state
 - Court rejected FL DOR’s application of market-based sourcing to taxpayer businesses based on the plain language of the FL apportionment regulation providing for use of COP sourcing

61

Indirect tax litigation

Maryland Digital Advertising Tax litigation

- In 2021, Maryland became the first state to adopt a digital advertising services tax on annual gross receipts derived from digital ad services “in the state”
 - Imposed on entities with global gross revenue of at least \$100 million
 - Entities with \$1 million of digital ad revenue from MD sources required to file
 - Tax rates range from 2.5% to 10% based on amount of annual global gross revenue
 - Delayed effective date: applied beginning with 2022 tax year
 - Following enactment of the tax, lawsuits promptly filed in both state and federal courts challenging constitutionality of the tax on Commerce Clause, First Amendment and Internet Tax Freedom Act grounds

62

Indirect tax litigation

Maryland Digital Advertising Tax litigation

- State lawsuit (*Comptroller of Md. v. Comcast of CA/MD/PA/VA/WV LLC et al.*):
 - October 2022: Maryland state trial court struck down the tax on Internet Tax Freedom Act, Commerce Clause, First Amendment grounds
 - May 2023: Maryland Supreme Court dismissed the case on grounds that litigants failed to exhaust administrative remedies before filing the lawsuit – tax stands
- Federal lawsuit (*U.S. Chamber of Commerce v. Lierman*):
 - Largely dismissed for lack of jurisdiction under federal Tax Injunction Act
 - Remainder of lawsuit dismissed for mootness after state trial court ruled the tax unconstitutional
 - Chamber asked Fourth Circuit Court of Appeals to revive challenge after the Maryland Supreme Court dismissed the state litigation on procedural grounds

63

Other tax litigation

Washington capital gains tax

- *Quinn v. Washington*, Wash. Supreme Court, Mar. 24, 2023
 - WA Supreme Court upheld constitutionality of Washington’s long-term capital gains (LTCG) tax on individuals enacted in 2021, became effective in 2022
 - WA imposes a 7% tax on WA-allocated LTCG of individuals exceeding \$250,000 resulting from the sale of certain capital assets
 - Enacted to supplement state’s revenues given lack of a traditional income tax
 - Taxpayers filed lawsuit in state court in April 2021, arguing tax is a property tax on income in violation of uniformity and levy limitations on property taxes under the WA Constitution
 - Court held that LTCG constitutes a valid excise tax levied on the sale or exchange of capital assets that does not violate the WA Constitution or Commerce Clause of U.S. Constitution
 - LTCG tax “falls on the excise tax side of the line because it taxes transactions involving capital assets – not the assets themselves or the income they generate”

64

Unclaimed property litigation

MoneyGram case

- *Delaware v. Pennsylvania et al. & Arkansas et al v. Delaware*, No. 220145 & 220146, U.S. Supreme Court, Feb. 2023: first unclaimed property case before the U.S. Supreme Court in over 30 years
- Involves a long-standing dispute between DE and 30 other states over which state is entitled to escheat approximately \$300 million in uncashed bank checks issued by MoneyGram Payment Systems
 - DE position: MoneyGram checks are third-party bank checks that should be escheated to state of incorporation (typically DE) if last known address of property owner is unknown
 - PA and other states: checks are money orders, falling under jurisdiction of a federal unclaimed property statute that says such checks escheat to state of purchase
- U.S. Supreme Court ruled that uncashed teller/agent checks escheat to state of purchase since instruments are similar in nature to money orders and federal law applies instead of common law rules pointing to state of incorporation

65

Questions?

