



The changing tax legislative landscape:
Considerations for businesses, investors,
and the real estate industry

Select SALT topics

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POLLING QUESTION #1

Is your company organized as a pass-through entity (PTE) or do you have pass-through entities that your company owns an interest in either directly or indirectly?

A

We are a PTE

B

We own interest(s)
in PTE(s)

C

Both A and B

D

Neither A nor B

Presenters



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Agenda

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State Income Tax Developments

- MTC Partnership Project
- Jurisdiction and Nexus
- Sourcing and Apportionment Issues
- Sale of Partnership Interest/Assets
- Enforcement Issues
- State Conformity to Federal Partnership Audit Rules
- Pass-Through Entity Tax Elections & Considerations

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Property Tax Considerations



State income tax developments



MTC Partnership Project

- The Multistate Tax Commission (MTC) is an organization of “member states” that seeks to increase uniformity on state tax issues.
- In March 2020, MTC staff issued an outline summarizing the questions, issues, and perceived potential for abuse through the use of partnerships.
- A Standing Subcommittee was formed in March 2021, and the issues to be addressed were identified.
- The first meeting of the Work Group was in June and there have been six meetings since.
- No formal recommendations have been issued to date, but you may want to monitor this.
 - <https://www.mtc.gov/Uniformity/Project-Teams>
 - Individual states would need to take action to adopt any eventual recommendations of the MTC.

Nexus issues for pass-through entities and their corporate owners

- Initial nexus question:
 - Does merely holding an interest in a PTE create nexus for the owner with the state in which the PTE does business?
 - For corporations – Merely holding shares of stock in a subsidiary is not enough to create nexus.
 - For PTEs – the US Supreme Court has never addressed the question.
 - But the states have addressed the question:
 - Varies by state depending upon whether the corporate partner is a LP or GP
 - Is an LLC member like a limited partner?
 - Nexus (**constitutional**) vs. “Doing business” (**statutory**)
 - Some states expressly provide, either by statute or regulation, that owning an interest in a pass-through entity is sufficient to create a taxable nexus in the state.
 - Emergence of “brightline” or economic nexus standards draws in members of PTEs doing business in the state.

Sales Factor-Based Nexus Standards

Jurisdiction	Year	Sales Factor Threshold
Ohio (CAT)	2005	\$250,000
Washington (B&O)	2010	\$267,000
Connecticut	2010	\$500,000 (regulatory)
Colorado	2010	\$500,000
California	2011	\$637,252 (1/1/2021)
Michigan	2012	\$350,000
New York State	2015	\$1,000,000
Nevada (Commerce Tax)	2015	\$4,000,000
Alabama	2015	\$538,000 (1/1/2019)
Tennessee	2016	\$500,000
Massachusetts	2019	\$500,000 (regulatory)
Hawaii	2020	\$100,000
Pennsylvania	2020	\$500,000
Texas (Margin Tax)	2020 Report Year	\$500,000
Maine	2022	\$500,000

Recent California Developments Addressing Owner Filing Obligations

California “Doing Business” Cases

- ***Sup, Inc.***, CA SBE 571262 (Mar. 7, 2013) (not citable)
- ***Swart Enterprises, Inc. v. CA FTB*** (Cal. Ct. App. 5th Dist. Jan. 12, 2017)
- ***In the Matter of the Appeal of Satview Broadband, Ltd.***, OTA Case No. 18010756 (Sept. 25, 2018)
- ***Appeal of Jali, LLC***, OTA Case No. 2019-OTA-204P (July 8, 2019)
(posted online Sept. 4, 2019 and becoming precedential on Oct. 8, 2019)
- ***Appeal of Wright Capital Holdings LLC***, OTA Case No. 2019-OTA-219P (Aug. 21, 2019)
(pending precedential) (posted online Oct. 9, 2019)
- ***In the Matter of the Appeal of GEF Operating Co.***, OTA Case No. 2020-OTA-057P (May 9, 2019),
rehearing denied OTA Case No. 2020-OTA-058 (Mar. 30, 2020)
- ***Appeal of LA Hotel Investments #3, LLC***, OTA Case No. 2021-OTA-218P (May 13, 2021)
(pending precedential)(posted online Jul. 7, 2021)

POLLING QUESTION #2

Has your company been involved in an audit where a state claimed nexus solely because of an ownership interest of a pass-through entity in that state?

A

Yes

B

No

Apportionment of Pass-Through Entity Income

Partner level vs. Entity level?

- Is business/nonbusiness income determination made at:
 - The partnership level?
 - The partner level?
- Not much guidance – only a handful of states have addressed
- A.k.a.: “Aggregate vs. Entity” theory
 - Apportionment factors flow up?
 - Or, are the corp. shareholders “stuck” with the partnership’s factors?



Apportionment of Pass-Through Entity Income

Partner level (or Aggregate) approach explained:

- Partners combine their share of PTE apportionment factors with their other apportionment factors.
 - Referred to as “flow-through” or “flow-up” apportionment
 - Majority view
- Example:
 - If a corporation has a 60% interest in a partnership, the corporate partner would calculate its own apportionment factor by including 60% of the partnership's sales, property, and payroll (assuming that the state uses a three-factor apportionment formula).

Apportionment of Pass-Through Entity Income

Entity approach explained:

- PTE's income apportioned to the state using only the PTE's own apportionment factors.
- Owners of the PTE then allocate their distributive share of post-apportionment income to the appropriate state.
- Example:
 - Corporate partner has a 60% interest in a partnership which earns \$100 of income.
 - If apportionment is calculated at the partnership level and the partnership computes a 50% apportionment factor in a state, the partner would include \$30 of partnership income in its tax base in that state, which is 60% of the partnership's income in the state after apportionment.
 - (i.e., $\$100 \times 50\% = \50 , and $\$50 \times 60\% = \30).

Apportionment of Pass-Through Entity Income

- Generally, state apportionment follows the percentage flow-through of partner's distributive share used for federal tax purposes.
- It should be noted that distribution of income and loss do not have to align with the partner's ownership interests.
 - Under a partnership agreement, income, loss, and credits can be distributed under an alternative method – not necessarily based on ownership percentages.
 - The distribution of income can be calculated based upon the profitability of the PTE or the value of the property contributed by a partner.
 - Additionally, the partnership agreement can distribute income and losses under different percentages from year to year based upon various criteria and measurement.
 - However, on a yearly basis apportionment and income flow-through should be consistent with the partner's percentage distribution of income.

Apportionment of Pass-Through Entity Income

California

- See Cal. Code Regs. tit. 18, § 25137-1.
 - If partners are UNITARY with partnership, then partnership's factors "flow through" to the partners.
 - If partners are NOT unitary with the partnership, then the factors do not "flow through" to the partners.
 - If partners and partnership are NOT unitary, but the income is considered business income, partners must apportion partnership income separately from their other business California income.

Sale of a Partnership Interest or Assets

- For state and federal income tax purposes, the sale of an interest in a pass-through entity is generally treated as the sale of an intangible asset.
- The sale of all or part of the assets of a pass-through entity, on the other hand, will generally give rise to allocable or apportionable income in the state where the assets are located.
- Many states also apply look-through tax treatment to deemed asset sales even though the seller actually sold a membership interest in the pass-through entity, not the entity's assets.

Sale of a Partnership Interest or Assets

- Statutory test:
 - Business income:
 - Include or exclude from apportionment factor
 - Nonbusiness income:
 - Allocate
- Constitutional test:
 - *Allied-Signal*, 504 U.S. 768 (1992)
 - *MeadWestvaco*, 553 U.S. 16 (2008)
- Some states apply look-through rules to apportion gain.



Sale of Partnership Interest

California Corporate Tax Rules

If treated as business income, the gain (or loss) is included in apportionable income, and the proceeds are assigned as follows:

- For sales after 1/1/2013, market-based sourcing rules in CCR §25136-2 provide for look-through treatment for sale of partnership interests.
 - If *50% or more* of the underlying partnership's assets at the time of sale consist of **tangible property**, then proceeds are assigned to the numerator of the sale factor by averaging underlying **partnership's payroll and property factors**.
 - If *more than 50%* of underlying partnership's assets at the time of sale consist of **intangibles**, then proceeds are assigned to the numerator of the sales factor based on the underlying **partnership's sales factor**.

Sale of Partnership Interest

California Corporate Tax Rules

If treated as nonbusiness income, the proceeds are excluded from apportionment and the gain is reported as follows:

- Sourcing of nonbusiness gain; CRTC §25125 (d) provides for look-through treatment on the sale of a partnership interest held as a nonbusiness asset.
 - If *50% or more* of the underlying partnership's assets consist of **tangible property**, gain allocated to California based on **ratio of tangible property** in California to tangible property everywhere, determined at the time of sale.
 - If *more than 50%* of the underlying partnership's assets consist of **intangibles**, gain allocated to California based on the partnership's **prior-year sales factor**.

Sale of Partnership Interest

Noell Industries, Inc. v. Idaho State Tax Commission, 470 P.3d 1176 (ID 2020), cert. denied, 209 L. Ed. 2d 130 (2/22/21)

- Issue: Was \$120 million capital gain Noell Industries, Inc. (“Noell”) realized from selling its entire 78.54% interest in Blackhawk Industries Products Group Unlimited, LLC (“Blackhawk”) business income under Idaho Code section 63-3027?
- Idaho Supreme Court holds that the unitary business test is “part and parcel” of business income question.
- Idaho rule defining “business income” incorporates the unitary business concept (both transactional and functional tests).
- Court concludes that the sale did not satisfy either test.
- Idaho State Tax Commission files cert. petition, but U.S. Supreme Court denies without comment Feb. 22, 2021.

Sale of Partnership Interest

- **New York** – *Nonresident Partner’s Treatment of Gain or Loss on Certain Sales or Transfers of a Partnership or Membership Interest*, TSB-M-18(2)I (April 6, 2018):
 - Guidance in response to 2017 Budget Law amendment (2017 Laws, ch. 59 (NY 2017 Budget bill (Part AA) – amending NY Tax Law §632(a)(1)).
- If a nonresident is a partner in a partnership where a sale or transfer of the interest of the partner is subject to IRC §1060, any gain recognized for federal income tax purposes from the transaction is treated as New York source income allocated based upon the New York Business Allocation Percentage (BAP) during the year of the sale or transfer. No minimum ownership threshold.

Sale of Partnership Interest

Matter of Goldman Sachs Petershill Fund Offshore Holdings Corp.,
TAT(E)16-9(GC) (NYC Tax Appeals Tribunal, Mar. 12, 2021) (on appeal)

- Corporation with no business activities in New York City sold passive minority interest in LLC doing business in NYC.
- LLC was taxed as a partnership for federal and NYC income tax purposes.
- Parties stipulated that corporation-member was not engaged in a unitary business with the investee-LLC.
- Nevertheless, in 2019, a NYC administrative law judge (ALJ) held that the corporation was subject to tax in NYC on the gain from its sale of a minority interest in the LLC.
- The New York City Tax Appeals Tribunal (“TAT”) affirmed the ALJ’s ruling, concluding that the corporation’s distributive share and capital gain from the sale must be treated as part of the LLC’s unitary business, and thus should be apportionable to NYC.
- Currently on appeal.

POLLING QUESTION #3

Which of the following best describes your company's analysis of the state tax consequences of selling an interest in a pass-through entity?

A

We automatically treat any gain as nonbusiness income and source it to our domicile. Bring on the audit!

B

We prepare a bunch of spreadsheets to figure out the benefits of allocating or apportioning the gain in each given state. Those aren't discoverable, right?

C

We independently evaluate the transaction under the laws of each state in which the entity was operating to determine how the gain should be treated on a state-by-state basis.

Enforcement Issues – Withholding

- Most states require withholding on nonresident partners as a means of enforcing filing.
- Withholding does not always satisfy the nonresident partner's filing requirement. A partner must file a return to get a refund of any amounts over withheld.
- Withholding rates are often lower than income tax rates.
 - E.g., California, the domestic nonresident partner withholding rate is 7%, while the corporate tax rate is 8.84% and the highest marginal individual tax rate is 13.3%.
 - E.g., Georgia, the nonresident partner withholding rate is 4%, while the individual & corporate tax rates are 6%.
- Common exemptions and exceptions
 - Some states exempt a partner if they submit an affidavit affirming that the partner will file a return.
 - Waiver, or a reduced rate of withholding based on certain criteria (e.g., nonresident filing income tax returns with the state for the past couple of years).
 - Exemptions for *de minimis* amounts
 - Publicly traded partnerships
 - Qualified investment partnerships

Enforcement Issues – Composite Returns

- A single return filed to satisfy the state filing obligations for the entire group of electing nonresident taxpayers.
- Most states limit composite return to individual partners and trust partners.
- Some states require that permission must be received before filing a composite return.
- Individuals who elect to be in a composite return usually cannot file an individual return.
- Cannot participate if partner has in-state sources of income other than from ownership in a partnership. However, participation in multiple composites is generally permitted.
- Pros
 - Streamlined – partners do not file on their own.
 - Cost – filing single return costs less than filing several individual returns.
- Cons
 - No graduated rates.
 - No itemized/standard deductions.
 - No NOL carry-forwards.
 - Partnership is taking on additional responsibility and costs.

POLLING QUESTION #4

Select the one that applies to you.

A

My company submits an agreement or consent to income tax jurisdiction in the states where its partnership or LLC does business.

B

My company does not submit this consent and relies on the partnership or LLC to file a composite return with the states.

State Conformity to Federal Partnership Audit Rules

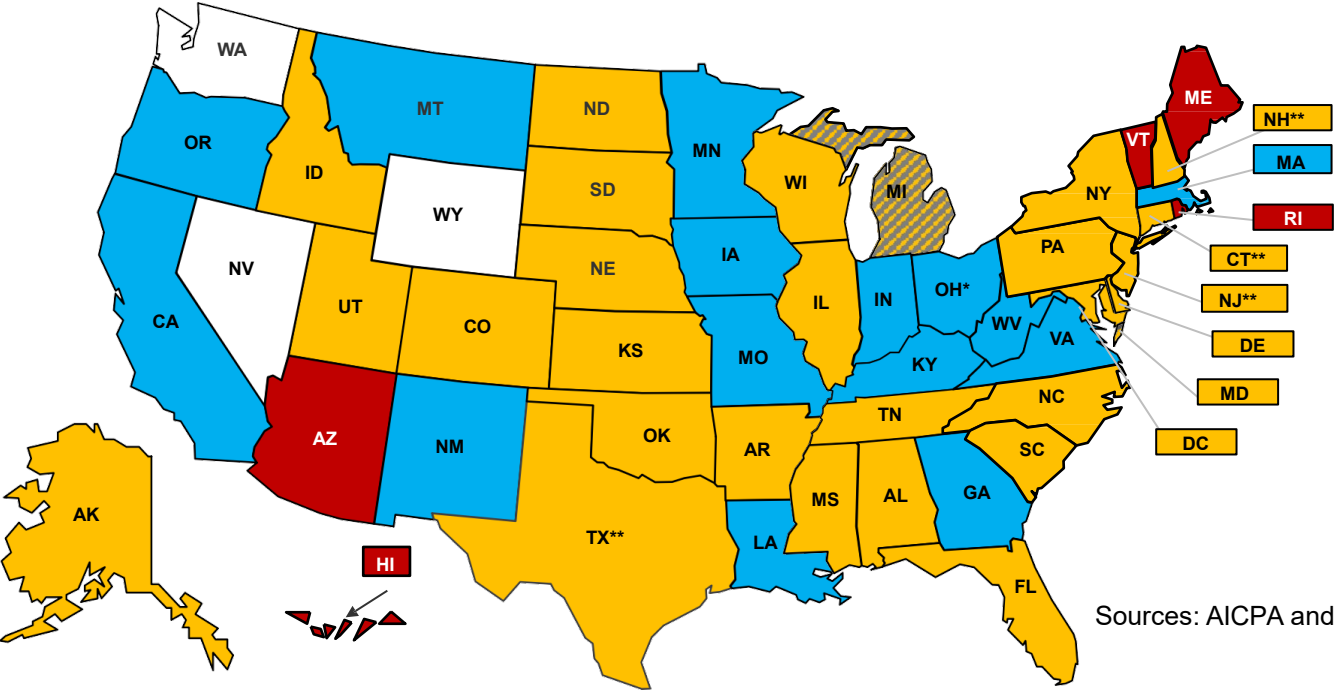
- MTC worked with the Interested Parties to develop a model:
 - ABA Section of Taxation SALT Committee Task Force (ABA)
 - American Institute of CPAs (AICPA)
 - Council On State Taxation (COST)
 - Institute for Professionals in Taxation (IPT)
 - Master Limited Partnership Association (MLPA)
 - Tax Executives Institute (TEI)
- Model can be found at: <http://www.mtc.gov/Uniformity/Project-Teams/Partnership-Informational-Project> (updated October 2020).
- Model also addresses state filing obligations post-RAR.

Comparison of Federal Process to Model Act

Federal Audit Reporting Process	MTC State Model Process
<p>Default – Partnership pays the tax using highest individual/corporate income tax rates.</p>	<p>Default – Partnership notifies partners and partners pay the tax (composite/withholding filers still subject to partnership paying the tax).</p>
<p>Has option for partners to file amended returns (or simply pay (“pull-in”)) to remit tax.</p>	<p>Such partners required to report under the general reporting requirements at the state level (<i>i.e.</i>, file separate amended state return). Those partners are <u>not</u> included in any partnership pays tax calculation.</p>
<p>Has option for partnership to “push out” tax to review year partners to remit the tax when they file their tax return for the year IRS completes the audit (adjustment year).</p>	<p>“Push-out” option requires reporting and payment on an amended return for original (“reviewed”) year. Ability to report/pay tax on current year tax return unavailable (likely an administrative systems issue w/most states).</p>
<p>Tiered Partners – must complete all filings by the extended due date of the Audited Partnership's return for the adjustment year.</p>	<p>Subject to extension, Tiered Partners must complete all reporting and payments 90 days after the extended due date of the Audited Partnership's return for the adjustment year.</p>

State Adoption of MTC Model

As of August 2, 2021



- **15 States that have enacted** legislation that generally follows the MTC Model (CA, GA, IA, IN, KY, LA, MA, MN, MO, MT, NM, OH, OR, VA, WV)
- **5 States that have enacted** legislation, **but need improvement** to more closely follow MTC Model (AZ, HI, ME, RI, VT)
- **States that potentially need** legislation
- ▨ **1 State with 2021 pending** legislation (MI)

Sources: AICPA and COST

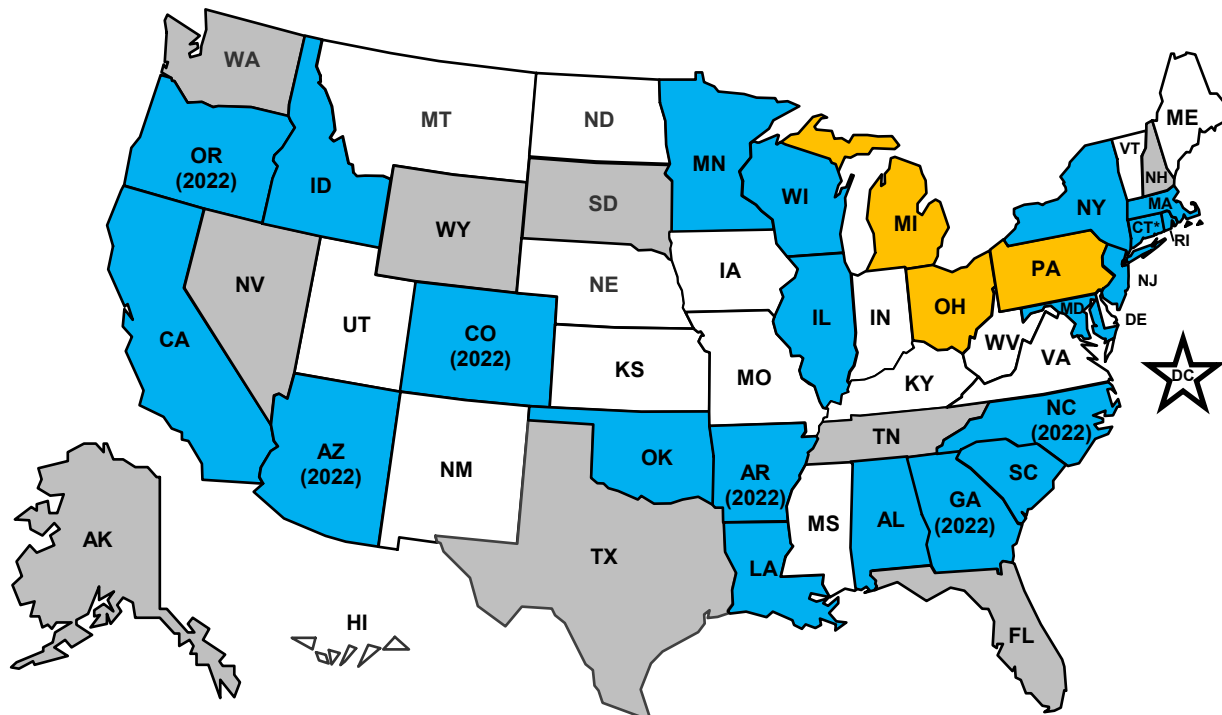
* **Ohio** only addressed the partnership audit issue at the state income tax level but not for the local income taxes.

** **4 States** with mandatory entity taxes on partnerships – may need to incorporate the general provisions of the MTC model statute but potentially may not need the specific election provisions of the MTC model statute (**CT, NH, NJ, TX**).

Pass-Through Entity Taxes (PTETs)

States With Adopted or Proposed Pass-Through Entity (PTE)-Level Tax

As of November 19, 2021



● States that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:

AL, AR¹, AZ¹, CO¹, CT², GA¹, ID, IL, LA, MA, MD, MN, NC¹, NJ, NY, OK, OR¹, RI, SC, WI

¹ Effective in 2022 or later

² Mandatory

● States with proposed PTE tax bills:

MI – HB 5376, first reading

OH – SB 246, in committee

PA – HB 1709, in committee

● No owner-level personal income tax on PTE income

Considerations When Making a PTET Election

- Is the PTET elective or mandatory? What percentage of owners is required to make the election?
- Does the PTET regime provide a full or partial credit to owners for taxes paid?
- Does the PTET regime exclude the PTE's income from owners' returns?
- Does the PTET include the distributive share of otherwise exempt owners?
- Is there nonbusiness income that will be sourced to a state if the election is made?
- Is the PTE required to make estimated tax payments?
- Will other states allow a credit for the PTE tax at the owner level?
- Double-check your operating agreement:
 - Does your operating agreement permit the PTE to elect into a PTET?
 - Do the allocation provisions properly allocate any PTET to each partner in a way that reflects the partner's share of the economics?
 - If there is a cash distribution provision, are distributable earnings reduced by partner's share of any PTET expense?
 - Are guaranteed payments reduced by the partner's share of any PTET expense?

Property tax considerations



Crowe Property Tax Reduction Strategy/Opportunity Review

There are eight primary areas of opportunity for property tax reductions. These areas include:

- Timing
- Tax Law and Administration
- Accounting
- Operations
- Return/Rendition Filing Options
- Appraisal
- Uniformity and Incentives

Prop Tax Tools & Processes (continued)

PT Basis Analyzer (Including but not limited to the following):

- Identification and stratification of higher-dollar properties and assets
- Unrecorded Disposals/Ghost assets
- Refurbish/Restore/Renovation Cost Reductions
- Classification:
 - Personal vs. Real
 - Favorable Asset Classes
 - Sub-Classification for Soft Costs, Non-Material, Intangibles
 - Location Assignment
 - Inventory vs. Raw Materials vs. Supplies
 - In-Transit Property
- Alternative Accounting – Historical Cost, Purchase Price Allocation
 - Transaction Acquisition Cost
 - Prior-Company Cost
 - Purchase Price Allocations
 - Original Cost as previously filed
- Write-Downs/Write-Offs

Prop Tax Tools & Processes (continued)

PT Value & Obsolescence Analyzer (Including but not limited to the following):

- Replacement/Reproduction Cost New Considerations
- Prototyping/Benchmarking/Modeling
- State Requirements and Limitations
- Identification and stratification of higher-dollar properties and assets
- Value Analysis
 - Cost Approach
 - Market/Sales Comparison Approach
 - Income Approach
 - Unitary Valuation
- Depreciation Studies
 - Service Life vs. Economic Life
 - Salvage or Scrap Value

Prop Tax Tools & Processes

PT Value & Obsolescence Analyzer (Including but not limited to the following):

- Obsolescence Quantification/Studies
 - Inutility
 - Replacement Cost New
 - Cost to Cure/Future Capex
 - Loss of Investment/ROI
- Weighted Average Cost of Capital
- USPAP Appraisal
 - Real Estate
 - Inventory
 - Machinery & Equipment
 - Total Facility/Property
- Competitor Assessment/Procedure Review





Thank you

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