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State and Local Tax and COVID-19: Recognize the Risks and Take Advantage of the Opportunities

Understanding obligations and available state tax relief will help businesses navigate the pandemic.

As businesses continue to assess the myriad implications of the COVID-19 pandemic, one area of focus should be on the impact of legislation, regulations and guidance issued at the state and local levels. This becomes increasingly more complex for businesses that operate or have employees in multiple states. Over the past several months, state and local governments have released various tax-related measures in response to the coronavirus pandemic, addressing areas such as state income tax, sales and use tax, property tax and unclaimed property. These measures could affect state tax obligations. In addition, some states have introduced measures that provide relief and/or incentives to businesses.

State Income Tax

The COVID-19 pandemic is forcing millions of employees to work remotely, and there are three potential state tax impacts that could result: nexus, payroll tax withholding and apportionment. With limited—and sometimes inconsistent—guidance from states, businesses will need to monitor these issues closely and address them as they arise.

The first issue is whether having an employee work remotely due to COVID-19 will create a taxable presence (or nexus) for the employer in that state even if the employer does not carry out any other nexus-creating activities in that state. To date, at least 15 states have issued guidance regarding teleworking employees and nexus. In most cases, states have indicated that nexus is not created by an employee teleworking in the state due to COVID-19. While this is a welcome clarification, some questions remain unanswered, such as the nexus implications for businesses once a state lifts its emergency order or where the business lifts its own stay-at-home requirement, but the employee continues to work from home. In states that have not issued guidance on the nexus implications of employees working remotely, businesses may have nexus and new filing and compliance requirements.

Second, state payroll tax withholding obligations should be considered. To date, only six states have issued guidance on the withholding tax requirements for wages paid to employees working remotely. In some cases, states have indicated that employers do not need to withhold tax for employees who are working in that state due to COVID-19, while other states have taken the opposite position. In addition, employees working from home in a state other than the state where the employer's facilities are located must determine whether their residence state will grant a credit for taxes paid to the employer's state. In certain situations, teleworking employees could be subject to double taxation if both the employer and employee's states require wage withholding.

Third, teleworking employees impact business' apportionment factors. Only a few states have provided guidance in this area, likely because most states have shifted to a single sales factor formula without a payroll factor; thus, the state does not have to address how to source a teleworking employee's wages for payroll factor purposes. However, businesses that generate service revenues will need to consider those states that adopt cost-of-performance sourcing for service revenues. Those revenues may need to be sourced to a different state due to the location of the teleworking employees. Changes in revenue sourcing could create a higher or lower apportionment factor depending on whether the business or teleworking employees or both are located in a cost of performance state.

Sales and Use Tax

COVID has also had an impact in the sales and use tax area, such as nexus and filing obligations in new states, the introduction of new sales and use tax exemptions, and sales and use tax filing extensions and penalty abatements.

It has been more than two years since the U.S. Supreme Court issued its landmark decision in South Dakota v. Wayfair, in which the court held that a physical presence is not required for a remote seller to collect sales tax in the state provided the seller meets an economic threshold. Based on Wayfair, states are empowered to require remote sellers to administer sales tax; only two states (Florida and Missouri) have not revised their sales tax laws to adopt "economic nexus." However, all states that have enacted the concept of economic nexus (except Kansas) provide a safe harbor for small sellers. Many businesses are still evaluating the impact of economic nexus and in which states they are required to administer sales tax.

Businesses that were taking a no-nexus position in a state due to a safe harbor (e.g., annual sales under $100,000 and fewer than 200 transactions) may now have nexus because they have employees working remotely in that state. A few states (including New Jersey and Rhode Island) provide an exception when nexus is triggered because an employee is temporarily working from home due to COVID-19.

Some states have introduced new sales and use tax exemptions as a result of the coronavirus pandemic. For example, there is an exemption from self-assessing and remitting use tax on eligible items that are withdrawn from inventory and donated for COVID-19 assistance; in Indiana, the exemption extends to medical supplies, food and cleaning supplies.

Some states, like Florida and Texas, have expanded their back-to-school sales tax exemptions to include personal protective equipment (PPE), such as face masks and shields. Other states have bills pending to exempt the purchase of PPE from sales tax, although enactment of these proposals is likely to face some challenges. State general assemblies may not be in session until 2021 and, more fundamentally, states may object to new exemptions because they need the tax revenue to provide essential services.

Finally, some states have provided tax return filing extensions or abatements of automatic penalties. It should be noted that even if a state has not announced automatic relief, most states provide for an abatement of penalties due to "reasonable cause." Companies seeking an abatement of penalties should consider taking steps to avoid paying penalties, rather than paying and subsequently requesting relief.

Credits and Incentives

Many states have introduced new incentive programs and/or revamped existing ones to allow more businesses to benefit. While some of these programs have been widely publicized, other incentive programs must be sought out. California has expanded the Employment Training Panel Grant to give approval preference to industry groups that include many "essential businesses" and has raised the cap on allowed safety training. North Carolina has created a Job Retention Program specifically in response to COVID-19, which allows companies to apply for cash grants based on the prior year's payroll costs. Several states, including Massachusetts, Missouri and Ohio, have enacted grant programs to incentivize existing businesses to retool their facilities to produce PPE.

To help companies keep their employees safe and adjust to new protocols, some states, including Arizona, California and North Carolina, have updated existing training programs to include COVID-19-related training for incumbent workers. Other states have created specific COVID-19 safety training, developed by health and safety experts, which is offered to businesses free of charge.

Some states have postponed compliance requirements for existing incentive agreements. For example, Indiana and Ohio have announced they will not hold companies to 2020 employment commitments and are relaxing the enforcement of compliance reporting deadlines. Other states, such as Georgia, are adjusting headcount increase measurements for purposes of job tax credits; Georgia will allow companies to use 2019 headcount details if the 2020 headcount is skewed by short-term COVID-19-related job reductions.

In addition to programs offered at the state level, many city and county jurisdictions have developed their own programs to help companies deal with the detrimental economic effects of COVID-19. These programs include cash grants and zero-interest loans.

Property Tax

C corporations are well-known for their "double taxation" concept. That is, a C corporation is taxed on its earnings, and any dividend paid from the C corporation's earnings are also taxable to the shareholder while not being deductible to the corporation. To avoid the second layer of tax, shareholders often cause the C corporation to retain earnings rather than distribute dividends. However, shareholders may find the low tax rates and losses in 2020 an ideal time to pull cash out of their C corporations by taking dividends.

In California, voters will vote on legislation in November that would eliminate Proposition 13 (which limits property tax increases and reassessments) for most commercial businesses. This initiative, referred to as the "split roll," would be created to maintain Proposition 13 for specific property, while Proposition 15 would allow for the revaluation of commercial property on a consistent basis and eliminate the statutorily limited annual increase. If the initiative is passed, it could result in a significant increase in the California real estate tax for many businesses.

Businesses should begin gathering data to analyze the potential impacts to property values. Consideration should be given to factors associated with any reduced revenue, increase in expenses, changes in the workforce, non-utilization of assets, deferred maintenance and additional requirements as a result of COVID-19. Detriments to value should be incorporated through personal property filing on the 2021 renditions, as well as through reviews of real property assessments to potentially lower real property values for the appeal deadlines throughout 2021.

Unclaimed Property

All states have laws regulating the reporting and remittance of unclaimed property (also referred to as abandoned property or escheat). Unclaimed property can include various types of intangible property, as well as some tangible personal property, depending on state law. Common types of unclaimed property include uncashed payroll or commission checks; uncashed vendor checks; unresolved voids, unredeemed gift certificates and gift cards; customer credits, layaways, deposits, refunds and rebates; overpayments and unidentified remittances; and accounts receivable credits, including credits that have been written off and recorded as income or expense (e.g., bad debt, miscellaneous income, etc.).

A holder of unclaimed property is required to report the property to the appropriate state after the time prescribed by the state has passed (the dormancy period). The purpose is to ensure that the property is returned to its rightful owner, the premise being that the state is in a better position to hold the property and return it to the rightful owner, and, in the interim, property held and derivative funds earned on the property may be used for the public good. Jurisdiction over unclaimed property is in the state of the rightful owner's address, and if the owner's address is unknown, the state where the holder is incorporated/formed; thus, even organizations that operate in only one state can have unclaimed property obligations in multiple states.

COVID-19 has significantly impacted how businesses address unclaimed property compliance for two main reasons.

First, many businesses have furloughed staff or implemented reduction in workforce measures that have created delays in complying with escheat compliance deadlines. Escheat compliance filings are categorized into (a) spring filings, January 1 through July 1, and (b) fall filings, October 31 or November 1. Some states, including California, Illinois, Michigan, Pennsylvania and Vermont, have granted extensions or waived penalties or interest (automatically or upon request) for the spring filings. However, no extensions or automatic waivers of penalties or interest have been provided for fall filings. Instead, most states have provided holders with online filing and payment instructions. Missed deadlines could result in penalties and interest or create additional audit risk.

The risk of penalties and interest is potentially increased based on the 2019 New York high court decision in New York ex. rel. Raw Data Analytics LLC v. JPMorgan Chase & Co., N.Y. Supp. Ct., No 100271/2015 (August 30, 2019, appealed October 3, 2019), in which the court ruled that JP Morgan was not entitled to judgment as a matter of law for its failure to self-assess and pay interest on late-reported unclaimed property. Presumably, if this case stands, holders in New York will be required to self-assess interest. Failure to do so could result in additional costs. Other states will likely follow suit.

Second, many businesses' finance, treasury and/or accounting functions operate on a remote work or hybrid platform. This makes reviewing state mailings or notices in a timely fashion or accessing manual records or ancillary systems to assist in escheatment projects difficult. For example, Delaware sends notices to holders requiring them to enter into the state's Voluntary Disclosure Agreement (VDA) program or risk being audited. Many holders missed the opportunity to enroll in the Delaware VDA program by failing to file the form within 60 days of receiving an initial letter from the state. This is largely because individuals were not in the office to receive and review the letter and distribute to appropriate management. Delaware sent letters February 20, 2020, and extended the VDA deadline to July 18, 2020, but many businesses still missed the deadline and received audit letters the following week. Furthermore, the inability to be in the office where necessary records are kept can result in delays in compliance with voluntary disclosure and audit requirements. To date, most states and auditors have been flexible with the timing of requests due to COVID-19, but this flexibility is expected to decrease in Q4 2020 and into 2021

Businesses are likely to continue to operate in understaffed capacities and in a remote environment for an indeterminate period of time. Notwithstanding, holders of unclaimed property should consider dedicating some internal resources to address escheat compliance obligation or outsource the function to a third party to avoid the significant costs associated with non-compliance.

Insights

In summary, businesses should consider the following when navigating the complexities resulting from the effect of COVID-19 on their workforce:

- Be aware of and understand the tax legislation, regulations and guidance released at the state and local levels. While some states have announced that they will not assert nexus simply because employees are working remotely during the pandemic, in other cases businesses may have additional state tax filing obligations, such as income, sales and use, and payroll tax filings.
- Take advantage of state legislation and programs designed to assist businesses during the pandemic, such as new sales and use tax exemptions for PPE, new or revamped credit and incentive programs to expand training grants to include COVID-19, opportunities to reduce personal and real property tax assessments due to reductions in value as a result of the pandemic, and any additional opportunities to participate in unclaimed property VDA programs.
- Take advantage of filing extensions granted by the states, such as for state income tax, sales and use tax, credit and incentives, compliance reporting and unclaimed property filings. Businesses should be aware of and request penalty and interest abatements in cases where they have filed late; in some instances, an abatement may be automatic due to COVID-19 but in other cases the abatement must be requested.

Two of the most formidable hurdles businesses face are limited resources and competing priorities. Addressing risk, while understanding potential savings opportunities, will prepare businesses to emerge stronger from the uncertainty created by the pandemic.