Insights and Resources

As a member of the RSM US Alliance, we would like to share the following with you:

2022 state and local tax year-end guide

2022 RSM **STATE AND LOCAL TAX YEAR-END GUIDE**

State legislatures continued last year's busy agenda with another season packed full of tax cuts and other tax-related activity. Leveraging continued federal funding, positive tax collections and a ripe business environment, many states seized the opportunity to reduce taxes on individual and business taxpayers.

Tax increases were seldom discussed and even less often enacted. However, there may be reason for concern as inflation, global conflict, a more volatile stock market and tightening consumer spending are projected to weigh down budgets throughout fiscal year 2023. While rainy day coffers are making up a higher percentage of total expenditures than they have in decades, the long-term lower growth for all state tax collections suggests the next year may bring difficulty, especially as tax cuts in 2022 and the end of federal pandemic relief will likely reduce surpluses in the aggregate and increase the risk of shortfalls in some states.

Taxpayers should consider a variety of state and local tax issues as they enter 2023. First, the states have begun to seriously consider the Multistate Tax Commission's updated Public Law 86-272 guidance from late 2021. While the states were seemingly slow to respond, many have begun rulemaking or are considering other policies to adopt the guidance.

Next, many businesses in the middle market are still ill-equipped to fully understand the impact of a hybrid or fully remote workforce. Understanding where employees are, where business activities occur and the resulting tax impacts is critical to navigating a trend that is likely to continue for the foreseeable future.

For a comprehensive planning guide addressing all tax types, please consider reviewing RSM's 2022 year-end tax guide for businesses.

Additionally, many more states adopted pass-through entity taxes, amended existing law or provided new guidance. As of September 2022, 30 jurisdictions had adopted a workaround tax. While Congress has been largely silent on any extension or revision of the federal state and local tax deduction limitation, taxpayers should proceed cautiously before electing into a workaround tax due to the wide variety of provisions.

And finally, federal conformity continues to be a hot topic for many tax departments, especially with the possibility of more federal tax changes. We address many of these considerations below.

RECENT FEDERAL LEGISLATION TO KNOW

The Inflation Reduction Act of 2022, signed Aug. 16, includes provisions affecting both individual and corporate taxpayers. The legislation includes several tax components, including a 15% corporate alternative minimum tax, a 1% excise tax on certain stock repurchases, $80 billion in additional funding for the IRS, and a two-year extension of the excess business loss limitation rules under section 461(l). Please read RSM's alert on the legislation, Inflation Reduction Act passes Senate; House vote expected this week, for more information on the federal provisions.

REMOTE WORKFORCE

Remote work has remained a key issue for middle market businesses in 2022, even with mandatory pandemic-related shutdowns no longer a driving force. In industries where in-person work is not an inherent requirement for operation, many businesses have adopted fully remote or hybrid in-office/remote working arrangements as permanent options. The trends of high turnover rates and difficulties in finding talent that defined the labor market in 2021 have continued into 2022, incentivizing many companies to either hire remote workers to fill talent gaps or offer fully remote or hybrid work options to retain current employees. While affected businesses are still working to fully understand and balance the benefits of remote work with the accompanying challenges in employee management and efficiency, remote workforces are clearly here to stay for many businesses. As a result, the state tax issues associated with remote workforces continue to remain relevant for many middle market businesses and likely will for the foreseeable future.

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Three primary state and local tax concerns arise with remote or hybrid employees working in a different state than the business's home office:

First, a business without offices or other operations in a state could establish income tax or sales and use tax nexus based on the presence of employees in the state, even if the employee's activities are home-based. Though around 18 states offered nexus or withholding "safe harbors" for remote workers at some point during the pandemic, those temporary protections have now largely expired.

Second, if the employee resides or works in a state that differs from the employer's state, the shifting of the employee's responsibilities to remote locations can impact the sourcing of revenues in both states that adopt cost-of-performance and market-based sourcing type regimes.

Third, wages are generally sourced based on the employee's physical location or number of working days in the state. States generally treat any day worked in a state as part of this analysis. Hybrid employment arrangements for businesses physically proximate to state lines may create an additional layer of complexity, where employees may live and maintain a home office in a different state or local jurisdiction than where the business is located.

For more information on state and local tax issues due to remote work, please read RSM's articles **When the office can be anywhere, where are taxes paid?** and **Remote workforces are complicating state tax nexus and withholding.**

STATE TAX AMNESTIES

On April 13, the Kentucky legislature overrode the governor's veto of House Bill 8 to adopt a number of tax changes, including a provision for a state tax amnesty. The amnesty will run 60 days and is tentatively scheduled to begin at some point after Oct. 1, 2022, depending on when the necessary resources are obtained to run the program. Eligible participants will receive a 50% interest reduction and a complete waiver of penalties. Qualifying participants who fail to apply for amnesty are subject to additional penalties.

INCOME/FRANCHISE TAX DEVELOPMENTS

Robust tax collections coupled with continued federal pandemic relief funding and fiscal year 2022 budget surpluses in many states drove numerous rate reductions and other taxpayer-favorable legislative changes. Below is a selection of noteworthy 2022 legislative developments, key topics to consider and rate changes.

1. Select income and franchise tax developments

- California removes NOL and credit limitations.
  - On Feb. 9, California enacted Senate Bill 113, which, among other changes, ends the temporary limitations on the utilization of net operating loss (NOL) carryforwards and certain credits. Under previously enacted provisions, NOL carryforward deductions were suspended for tax years 2020–2022 for taxpayers with over $1 million of California taxable income. The newly enacted legislation removes this limitation on NOL utilization for the 2022 tax year and removes the $5 million cap on the usage of corporate income tax credits.

- Idaho enacts apportionment changes.
  - On March 17, Idaho enacted House Bill 563, which provides for several changes to the state's apportionment rules effective Jan. 1, 2022. The previous three-factor apportionment computation is replaced with a single-sales factor formula, and the cost-of-performance sourcing methodology for sales other than tangible personal property is replaced by market-based sourcing provisions.

- Texas Supreme Court rules on revenue sourcing.
  - On March 25, the Texas Supreme Court ruled in favor of the taxpayer in *Sirius XM Radio, Inc. v. Hegar*. The decision held that revenues for the taxpayer should be sourced based on the location of employees and equipment performing services, rather than the location of the customer. Analysis focused heavily on the correct interpretation and application of the state's "receipt-producing, end product act" rules. For more information, please read our alert Texas Supreme Court clarifies franchise tax services sourcing.

- Massachusetts rules on taxation of non-unitary partnership gain.
  - On May 16, the Massachusetts Supreme Judicial Court issued its decision in *VAS Holdings & Investments LLC v. Commissioner of Revenue*, which addresses the proper application of the unitary business principle and Massachusetts' ability to tax an out-of-state investor on its capital gains from the sale of non-unitary partnership interest. The court ultimately ruled in favor of the taxpayer, finding no statutory basis for the imposition of Massachusetts tax on the gain. For more information, please read our alert Massachusetts high court rules out of state investor not taxable on partnership interest gain.

- Massachusetts millionaires' tax heads for the ballot.
  - In June 2021, the Massachusetts legislature voted overwhelmingly to approve a proposed constitutional amendment commonly known as the millionaires' tax, or the Fair Share Amendment. The millionaires' Tax would impose a 4% additional tax on income in excess of $1 million effective Jan. 1, 2023. The legislature's approval of the amendment allows it to appear on the Nov. 8 general election ballot for voter approval. For more information, please read our articles Massachusetts so-called Millionaires' Tax heads to 2022 ballot and Massachusetts Millionaires' Tax ballot summary approved for November.

- New York City enacts bright-line nexus threshold.
  - On Aug. 31, New York Gov. Kathy Hochul approved Senate Bill 9454/Assembly Bill 10506, enacting a bright-line nexus threshold for city corporate income tax purposes. Under the bill, any corporation with over $1 million in receipts derived from New York City sources will be considered to have nexus with the city. For more information, please read our alert NYC changes: PTE tax election in 2022; receipts threshold adopted.

- Pennsylvania enacts economic nexus standard and market-based sourcing for intangibles.
  - On July 8, Pennsylvania enacted House Bill 1342, making several notable corporate income tax changes. In addition to the rate impacts previously discussed, the legislation codifies the economic nexus standard previously addressed in Corporate Tax Bulletin 2019-04, which states that entities having over $500,000 of receipts sourced to the commonwealth will have established nexus for corporate income tax purposes. The bill also provides for a change from cost-of-performance to market-based sourcing for revenues associated with several categories of intangible property. For additional information, please read our alert Pennsylvania budget includes significant state tax changes.

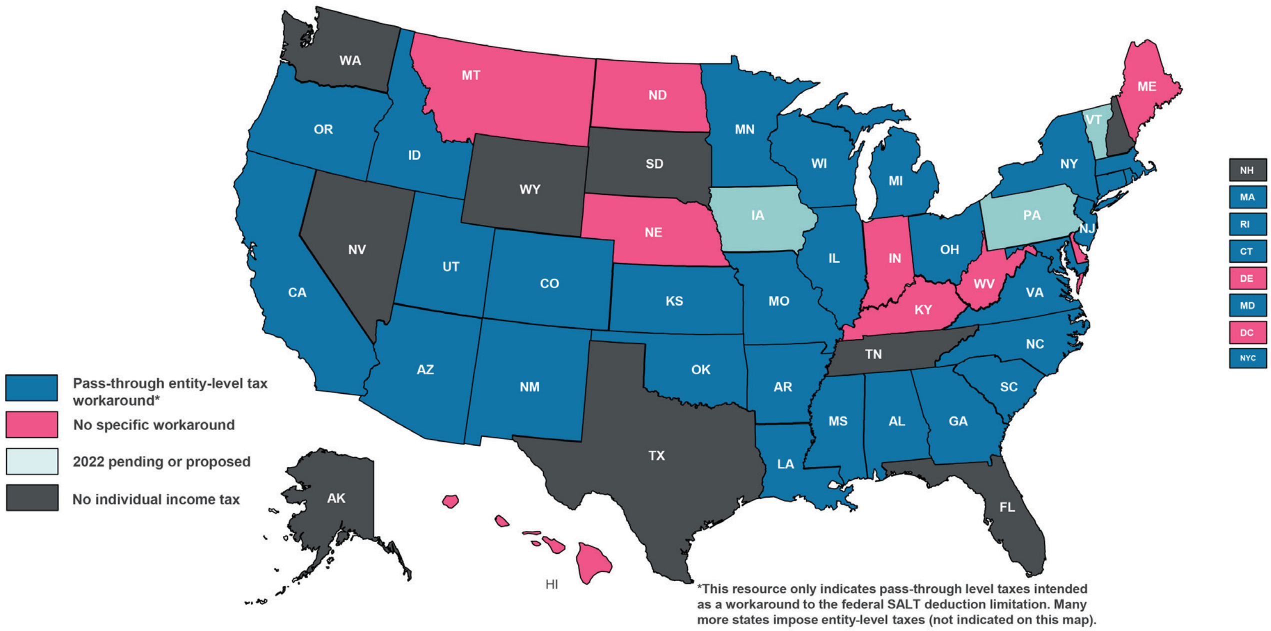
- Vermont enacts apportionment and combined reporting changes.
  - On May 31, Vermont enacted Senate Bill 53, which moves the state's apportionment factor computation to single sales factor and eliminates the state's throwback rule for sales of tangible personal property effective Jan. 1, 2023. The bill also provides that the state will move from using the *Joyce* method to the *Finnigan* method for computing the sales factor numerator for a unitary group filing a combined return. Additionally, the bill removes the state's historical 80/20 rule, which provided an exclusion from a unitary filing group for any entity with more than 80% of its property or payroll located in a foreign jurisdiction.

Numerous other income and franchise tax updates are addressed in RSM's quarterly SALT ASC 740 updates. Please read our summaries of state tax law changes for **quarter one** and **quarter two** of 2022 for more information.

2. State pass-through entity workarounds

The Tax Cuts and Jobs Act (TCJA, P.L. 115-97) limited the individual taxpayer deduction for SALT payments to $10,000 a year ($5,000 for a married person filing a separate return). SALT payments (including income and real property taxes) that exceed these amounts are no longer deductible by individual taxpayers unless the payments are in pursuit of a trade or business.

In response to the TCJA's limitation, states began to adopt a pass-through entity-level tax as a workaround. The intended benefit of the pass-through entity paying the tax is that the ultimate partner can recharacterize a nondeductible individual state income tax expense as a deductible entity-level state income tax expense for federal tax purposes. The taxes paid by the pass-through entity are deductible for federal income tax purposes, whereas the SALT limitation would apply if that tax were passed through to the member.



Many states adopted elective pass-through entity-level tax regimes prior to 2022, and several more, along with New York City, enacted legislation to do so this year. As of the date of this guide, the following jurisdictions have adopted a new workaround in 2022 (with the first effective year in parentheses): Kansas (2022), Mississippi (2022), Missouri (2023), New Mexico (2022), New York City (2022), Ohio (2022), Utah (2022) and Virginia (2021).

Additionally, Colorado previously enacted a pass-through entity-level tax but passed legislation in 2022 to make the election retroactively available to the 2018 tax year. States with workarounds enacted prior to this year include Alabama (2021), Arizona (2022), Arkansas (2022), California (2021), Colorado (2018), Connecticut (2018), Georgia (2022), Idaho (2021), Illinois (2021), Louisiana (2019), Maryland (2020), Massachusetts (2021), Michigan (2021), Minnesota (2021), New Jersey (2020), New York (2021), North Carolina (2022), Oklahoma (2019), Oregon (2022), Rhode Island (2019), South Carolina (2021) and Wisconsin (2018).

Pass-through entity tax workarounds may provide substantial benefit for some owners, but not all members may benefit from these elections. The specific mechanics of the computation of entity-level tax and the tax treatment of electing pass-through entity owners vary by state. A thorough analysis of all applicable factors is necessary to determine the overall benefit associated with making these elections. For more information on pass-through entity workarounds and relevant tax considerations, please read our article **Pass-through entity elections are here to stay: What you need to know.**

3. Public Law 86-272

The Interstate Income Act of 1959, commonly known as Public Law 86-272 or P.L. 86-272, generally prohibits states from imposing net income taxes on income derived from interstate commerce if the business activities in the state are limited to solicitation of orders of tangible personal property that are sent outside the state for approval and, if approved, are filled by shipment or delivery from a point outside the state.

In August 2021, the Multistate Tax Commission (MTC) unanimously adopted an updated version of its P.L. 86-272 guidance specifically to address internet activities. This latest guidance describes certain activities, such as placing cookies on customer computers, providing post-sale assistance through email or chat functions and accepting applications for employment online, as activities that exceed the protections of P.L. 86-272. The list of unprotected activities in the MTC guidance generally represents functionality and services associated with most modern websites and is widely applicable to taxpayers selling tangible products online. While the guidance does provide a carve-out for websites and apps that limit interaction to static text or photos, websites and apps have long been trending away from this narrow exception.

This updated MTC guidance continues to be a complex area for affected taxpayers to navigate. While no states are obligated to follow the MTC's guidance, over 22 states have indicated they intend to adopt the guidance in whole or in part. California was the first state to formally do so through the release of Technical Advice Memorandum (TAM) 2022-01 in February 2022, and several other states are already poised to follow suit. New York released draft regulations earlier this year generally adopting the latest MTC guidance, and revenue officials in both New Jersey and Oregon have recently indicated that their states intend to issue regulations to this effect.

More states will likely move to adopt the MTC's latest interpretation of P.L. 86-272 protections in the future. To read more about the MTC guidance in general and what it may mean for businesses currently taking or considering taking a P.L. 86-272 position, please see our article MTC adopts new P.L. 86-272 guidance: What you need to know.

4. Rate changes

Numerous rate changes occurred in 2022, in addition to previously scheduled adjustments. Many of the changes involve minor reductions to the corporate or individual income tax rate, bolstered by unexpected tax collections. Please note that the following descriptions do not reflect previously scheduled changes or reductions due to revenue triggers.

- Arkansas Senate Bill 1
  - On Aug. 11, Arkansas Gov. Asa Hutchinson approved legislation accelerating a reduction in the highest individual income tax rate from 5.5% to 4.9% and a reduction in the corporate income tax rate from 5.9% to 5.3% for tax years beginning on or after Jan. 1, 2023. The rate change was originally scheduled to take effect in 2025.
- Colorado Ballot Initiative 31
  - If approved by voters in the November general election, a ballot initiative would reduce both Colorado's personal income and corporate income tax rates from 4.55% to 4.40%. The rate reduction would be retroactive to Jan. 1, 2022.
- Georgia House Bill 1437
  - On April 26, Georgia Gov. Brian Kemp approved a bill to transition from the current graduated rate structure for individual income tax to a flat rate of 5.49%, beginning with tax year 2024. The bill also provides for scheduled 0.1% annual rate reductions, contingent on state revenue collection goals, until the individual income tax rate reaches 4.99% in 2029.
- Idaho House Bill 436 and House Bill 1
  - On Feb. 4, Idaho Gov. Brad Little approved House Bill 436, reducing both the highest marginal rate for individuals and the corporate tax rate from 6.5% to 6.0%, retroactive to Jan. 1, 2022. On Sept. 1, Gov. Little approved House Bill 1, replacing the current individual tax brackets with a single 5.8% flat rate (for incomes over $2,500 for single filers; $5,000 for joint) and reducing the corporate rate to 5.8%, effective Jan. 3, 2023.
- Indiana House Bill 1002
  - On March 15, Indiana Gov. Eric Holcomb approved legislation to reduce the individual income tax rate from 3.23% to 3.15% in 2023 and 2024. If certain revenue targets are met, the rate will be further reduced based on a schedule for years beginning after Dec. 31, 2024, with a potential rate target of 2.9% for tax years beginning after Dec. 31, 2028.
- Iowa House File 2317
  - On March 1, Iowa Gov. Kim Reynolds approved legislation to reduce both individual and corporate income tax rates. The top individual rate is reduced from 6.5% to 6.0% in 2023, 5.7% in 2024 and 4.82% in 2025, with tax imposed at a flat rate of 3.90% beginning in 2026. The legislation also provides for a system to incrementally reduce the corporate income tax rate, contingent on revenue collections. For more information, please read our alert Iowa enacts major tax reform package with reduced tax rates.

- Kansas Senate Bill 347
  - On Feb. 10, Kansas Gov. Laura Kelly approved legislation with a mechanism to reduce the state's current 7% corporate income tax rate in 0.5% increments until the tax is fully phased out. Note that all rate reductions are contingent on future capital investments and the construction of "qualified business facilities" by companies within the state.

- Kentucky House Bill 8
  - On April 13, the Kentucky General Assembly overrode Gov. Andy Beshear's veto of House Bill 8. The legislation will reduce the state's personal income tax rate from 5% to 4.5% in 2023, assuming certain revenue collection goals are met. For more information, please read our alert Kentucky targets personal income tax cuts; expands sales tax base.

- Louisiana Constitutional Amendment 2
  - On Nov. 13, 2021, Louisiana voters approved a constitutional amendment to reduce the corporate and individual tax rates previously enacted but not yet effective without voter approval. Accordingly, for corporate income tax purposes, Louisiana's five brackets with a top marginal rate of 8% are reduced to three brackets with a top marginal rate of 7.5%. For individual income tax purposes, the cap on individual income taxes is reduced to 4.75% from 6%. The required federal income tax deduction is eliminated for both taxes. Both the corporate and individual tax provisions are effective as of Jan. 1, 2022.

- Mississippi House Bill 531
  - On April 5, Mississippi Gov. Tate Reeves approved legislation that will eliminate the 4% income tax currently imposed on incomes between $5,000 and $10,000 for 2022, effectively exempting income up to $10,000, effective 2023. The flat tax rate on taxable income over $10,000 will remain at a rate of 5.0% in tax year 2023. That rate will decrease to 4.7% in 2024, 4.4% in 2025 and 4.0% in 2026.

- Nebraska Legislative Bill 873
  - On April 13, Nebraska Gov. Pete Ricketts approved legislation that will reduce the top personal income tax rate over the next five years from 6.84% to 5.84%. The legislation also expands on corporate rate cuts enacted in 2021 by providing for an additional four years of rate reductions, moving from 7.5% in 2022 down to 5.84% by 2027. For more information, please read our alert Nebraska enacts corporate and personal income tax rate cuts.

- New Hampshire House Bill 1221
  - On June 17, New Hampshire Gov. Chris Sununu approved legislation that reduces the state's business profits tax rate from 7.6% to 7.5% for tax years ending on or after Dec. 31, 2023.

- New York Senate Bill S8009C/Assembly Bill A9009C
  - On April 9, New York Gov. Kathy Hochul approved the state's budget legislation, which includes a two-year acceleration of individual tax rate reductions originally enacted in 2016. Single taxpayer income brackets currently taxed at 5.85% (for taxable income over $13,900, but not over $80,650) and 6.25% (for taxable income over $80,650, but not over $215,400) will be taxed at 5.5% and 6.0%, respectively, beginning in 2023. Reductions were also accelerated for the corresponding income brackets of married filers.

- North Carolina Senate Bill 105
  - On Nov. 18, 2021, North Carolina Gov. Roy Cooper signed legislation enacting significant changes to the state's tax regime, most notably the phaseout of the state's corporate income tax over the years 2025-2030. The state's current income tax rate of 2.5% will reduce to 2.25% for the 2025 tax year, 2% for 2026-2027, and 1% for 2028-2029. The corporate income tax is fully eliminated in 2030. The legislation also reduces the individual income tax from the 2021 rate of 5.25% to 4.99% in 2022, 4.75% in 2023, 4.6% in 2024, 4.5% in 2025, 4.25% in 2026 and 3.99% in 2027 and after.

- Oklahoma Senate Bill 1802
  - On May 5, Oklahoma Gov. Kevin Stitt approved legislation to reduce the corporate income tax rate from 6% to 4% for tax years beginning after Dec. 31, 2021.

- Pennsylvania House Bill 3418
  - On July 8, Pennsylvania Gov. Tom Wolf signed the fiscal year 2022-2023 budget and supporting legislation, providing for a scheduled corporate tax rate reduction. The state's current 9.99% rate will be reduced by a full percentage point in 2023, followed by half-percentage point reductions each year until the rate reaches 4.99% in 2031. For more information, please read our alert Pennsylvania budget includes significant state tax changes.

- South Carolina Senate Bill 1087
  - On June 17, South Carolina Gov. Henry McMaster signed legislation that adjusts the state's individual income tax from a six-bracket rate structure with a top rate of 7% to a three-bracket structure with a top rate of 6.5%. The change is effective for tax year 2022. The legislation also provides for 0.1% annual reductions in the top marginal rate until the rate reaches 6.0%, contingent on state revenue collections.

- Utah Senate Bill 59
  - On Feb. 11, Utah Gov. Spencer Cox approved legislation reducing the corporate and individual income tax rates to 4.85% from 4.95%, effective for tax year 2022.

SALES AND USE TAX

Sales and use tax collections continued to rebound throughout 2021 and through mid-2022. Nominally, collections in the second quarter of 2021 through the second quarter of 2022 were the five highest collection quarters ever. Quarter one of 2022 collections rose over 18% from the first quarter of 2021. Quarter two of 2022 rose another 5% over the same quarter in 2021. Whether strong sales and use tax collections will continue or level off will be closely watched as pandemic "revenge spending" eases and inflation remains at record highs.

Few legislative increases in sales tax base were enacted and there were no state sales tax rate increases, although there were many local rate increases. New Mexico surprisingly reduced the state rate from 5.125% to 5% effective July 1, 2022, with another one-eighth of a percentage reduction scheduled for July 1, 2023. Economic, or *Wayfair*, nexus has continued to help bolster state revenues, as has increased consumer spending coming out of the pandemic in areas like consumer goods and travel. However, the taxation of services, including professional services and cloud-based services, will continue to be considered, especially if states experience budgetary unease and lower collection growth in fiscal year 2023.

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1. Sales tax activity

- Aircraft exemptions
  - Alabama House Bill 20 reinstated the sunset provision for the sales and use tax exemption on certain aircraft parts, components and systems. The exemption is available for sales made through May 30, 2030, on contracts or projects entered into on or before May 30, 2027.
  - Virginia Senate Bill 701/House Bill 462 extended the exemption for certain aircraft components by another three years and eliminated the requirement that certain aircraft have a takeoff weight of at least 2,400 pounds.

- Grocery and food exemptions
  - Illinois Senate Bill 157, signed on April 19, suspended the 1% grocery tax for one year through June 30, 2023.
  - On June 17, Iowa Gov. Kim Reynolds signed Senate File 2367 clarifying the taxation of certain food products used in manufacturing. The exemption applies to property and services used by producers of food or food ingredients, without regard to the marketability for human consumption, retroactive to Jan. 1, 2019. For more information, please read our alert Iowa makes significant sales tax changes; reduces franchise tax rate.
  - Kansas House Bill 2106, signed May 11, adopts a schedule to fully phase out the sales tax on food by 2025, with a 2.5% reduction from the current rate in 2023, another 2% reduction in 2024 and a full phaseout by 2025.

- Gold, bullion or money
  - Alabama Senate Bill 13, signed by Gov. Kay Ivey April 14, extends a sales and use tax exemption for bullion or money until 2028.
  - Tennessee Senate Bill 1857, signed by Gov. Bill Lee on May 27, provides a sales tax exemption for coins, currency and bullion that are 1) manufactured in whole or in part from gold, silver, platinum, palladium and other material; 2) used solely as legal tender, security or a commodity in Tennessee or another state, the United States or a foreign nation; and 3) sold based primarily on their intrinsic value as precious material or collectible items rather than their representative value as a medium of exchange. Certain collectible paper currency also is included in the exemption.
  - Virginia House Bill 936, approved by Gov. Glenn Youngkin April 11, expanded the exemption of qualifying gold, silver or platinum bullion or legal tender coins and extended the exemption for an additional three years.

- General sales tax base
  - On June 17, Iowa Gov. Kim Reynolds signed Senate File 2367 eliminating the sales and use tax exemption for the purchase of computers and peripherals used in processing or storage of data or information by an insurance company, financial institution or commercial enterprise, effective Jan. 1, 2024. For more information, please read our alert Iowa makes significant sales tax changes; reduces franchise tax rate.
  - On April 13, the Kentucky General Assembly overrode Gov. Andy Beshear's veto of House Bill 8, which expands the sales tax to three dozen new services. For more information, please read our alert Kentucky targets personal income tax cuts; expands sales tax base.
  - On May 29, Maryland Gov. Larry Hogan allowed House Bill 791/Senate Bill 723 to become law, narrowing the definition of digital goods subject to the sales tax after allowing digital goods to be subject to the tax in 2021. For more information, please read our article Maryland narrows definition of taxable digital goods for sales tax.
  - On June 7, Vermont Gov. Phil Scott signed House Bill 738 expanding the sales and use tax exemption for manufacturing machinery and equipment so that manufacturing machinery and equipment that is part of an integrated production process is exempt.

2. *Wayfair* and economic nexus

Over four years ago, the U.S. Supreme Court issued its decision in *South Dakota v. Wayfair*, overturning the long-standing "physical presence" nexus standard established through *Quill v. North Dakota* in 1992. Soon after the decision, the states began to adopt economic nexus and marketplace nexus thresholds. Within two years, most of the states had adopted economic sales tax nexus. In just over three years, every state with a general sales tax adopted economic nexus. Missouri, the last holdout, adopted economic nexus and marketplace nexus in 2021, scheduled to be effective Jan. 1, 2023.

With universal adoption, the states have been busy clarifying hastily adopted marketplace provisions with little change to general economic nexus. In 2022, the states worked on clarifying many issues, such as whether marketplace nexus applies to peer-to-peer car rentals, accommodation aggregators, food delivery platforms, and other business activity that may not clearly reflect intended, or statutory, definitions of marketplaces. For general economic nexus, thresholds, periods and most rules remained unchanged.

For a more comprehensive summary and update on business considerations addressing *Wayfair*, please read our article, *Wayfair* nexus turns three by celebrating near universal adoption.

DIGITAL ASSETS ENTER THE VERNACULAR

The implementation of digital assets recorded on the blockchain has grown exponentially in the past decade. Individuals and businesses are using digital assets such as cryptocurrency to buy goods and services. Non-fungible tokens (NFTs)—unique digital assets representing a contract right for art, admissions and documentation, among others—are being sold, traded or used for numerous other purposes. Much like with traditional digital goods and services, the states continue to lag behind the pace of digital asset growth in providing guidance on taxability for all state and local tax types.

Both states and revenue authorities have recently taken action on the taxation of digital assets in 2022. A high-level summary of some of these developments follows below.

Arizona addresses airdrops and gas fees.

- On July 6, Arizona Gov. Doug Ducey signed House Bill 2204, excluding certain digital asset transfer transactions from state income tax to the extent they are not already excluded under the Internal Revenue Code. The bill provides that the value of virtual currency and NFTs received by taxpayers pursuant to an airdrop is not taxed at the time of the airdrop. "Airdrop" is defined as the receipt of virtual currency through a means of distribution to the blockchain addresses of multiple taxpayers. The airdrop exclusion does not apply to any appreciation in value of the digital asset occurring after the initial receipt from the airdrop. House Bill 2204 also provides a subtraction for gas fees not included in a taxpayer's virtual currency or NFT basis. "Gas fees" are fees paid to the operator of a virtual network for the use of the network to facilitate the purchase, sale or exchange of virtual currency or an NFT. The new provisions are effective beginning Jan. 1, 2023.

Michigan provides information on taxation of digital currencies.

- The state explains in the August Michigan Department of Treasury Update that the tax treatment of digital currencies for federal income tax purposes dictates their treatment at the state tax level.

Minnesota adds NFT guidance to its digital products fact sheet.

- Minnesota revised Digital Products Sales Tax Fact Sheet 177 to explain that NFTs are subject to sales and use tax when the underlying product (goods or services) is taxable.

New York final draft guidance explains sourcing cryptocurrency gains and losses.

- On July 1, the New York State Department of Taxation and Finance posted final draft guidance clarifying that cryptocurrency and other similar assets digitally delivered are included in the definition of digital products for state franchise tax purposes under Article 9-A. The explicit inclusion of cryptocurrency should provide taxpayers additional certainty for apportionment and sourcing purposes. Comments from the public on the final draft guidance were due by Aug. 26, 2022.

Pennsylvania subjects NFTs to sales tax.

- In June, NFTs were listed as taxable for sales and use tax purposes in the commonwealth's Retailer's Information REV-717, which discusses the application of sales and use tax to a variety of common items across a number of categories. The update did not include any explanation or reasoning behind the revision. It has also been reported that the enforcement of the tax on NFTs could potentially be retroactive to 2016, the year the commonwealth expanded the sales tax to include digital goods and products.

Washington state releases comprehensive NFT taxation guidance.

- On July 1, Washington state issued a guidance statement on the taxability of NFTs. The statement provides the most comprehensive explanation from a state revenue authority on NFT taxation to date, including a background on NFTs, definitions, price determination guidance, record retention guidance, a discussion of mixed transactions, gross income sourcing and apportionment guidance, and several examples. The statement explains that more permanent guidance should be anticipated.

Thank you for reading our 2022 RSM SALT year-end guide. Other sources of state and local tax updates can be found through our articles and alerts. Additional information is also available at the 2022 RSM Tax Summit, Tax in Motion.

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