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SALT Considerations During an Economic Slowdown

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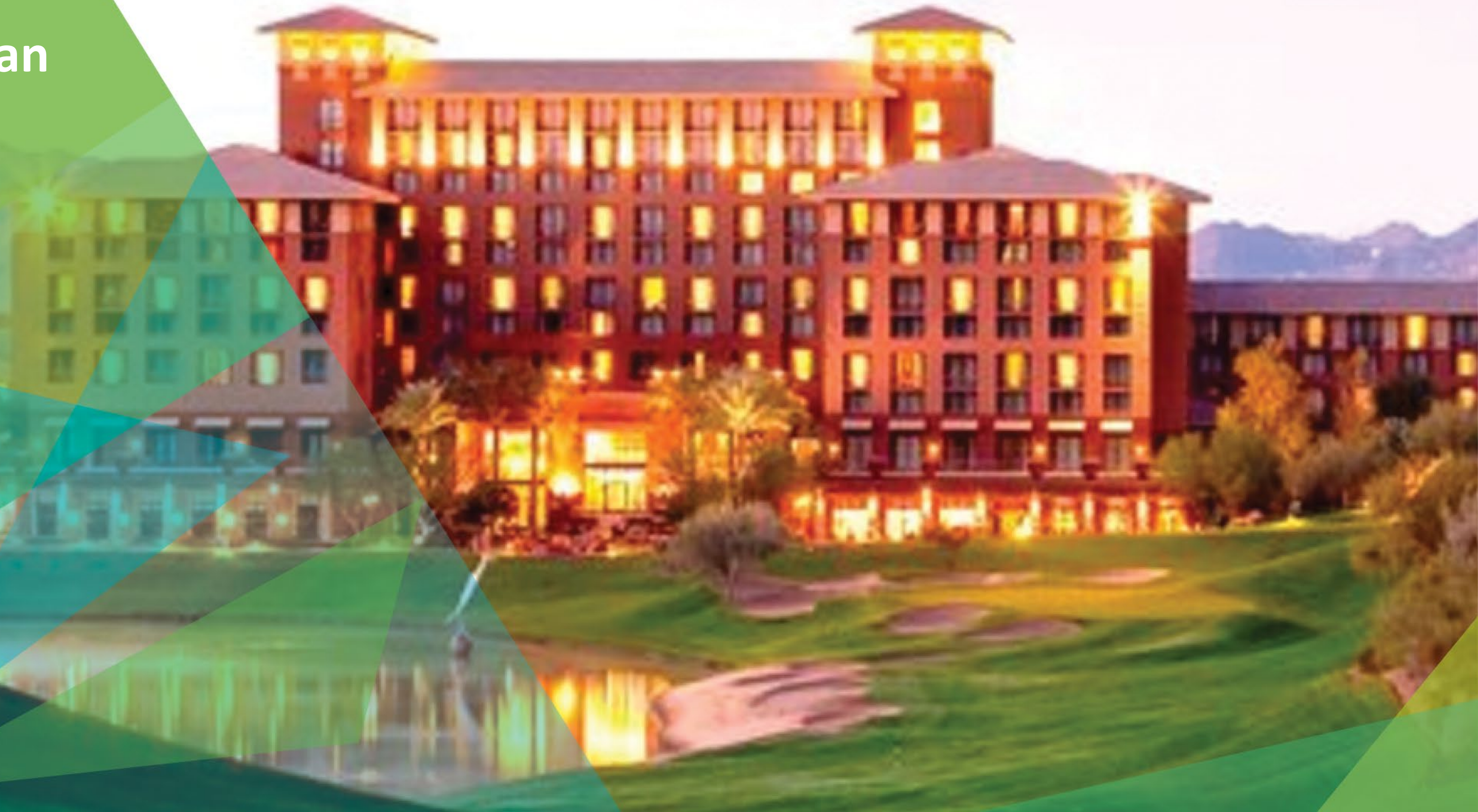

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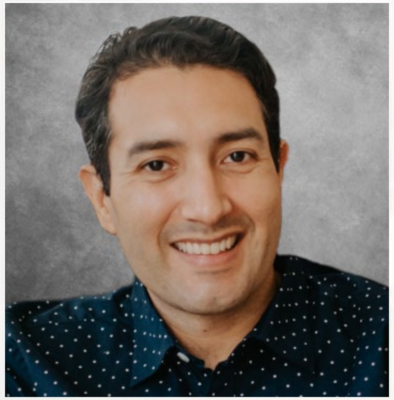
Moderator



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SALT Considerations During an Economic Slowdown

Sample conditions and areas of focus during an economic downturn to consider for state taxes:

- Heightened need for cash
- Contracting corporate earnings
- Changing interest rates
- State tax controversies and litigation
- Federal and state legislative activity
- NOL preservation
- Credits and incentives
- Business rationalization and budget issues

These factors will inevitably exist in the context of numerous others – such as recent legislative changes (e.g., IRA/CHIPS, ongoing TCJA matters such as mandatory section 174 capitalization) and company-specific circumstances. Tax planning during an economic slowdown will not be a "one-size-fits-all."

Heightened need for cash

- Companies may seek opportunities to preserve cash through up-front tax return filing positions (versus refund claims) and managing estimated tax payments.
- Companies may also look for opportunities to generate cash, such as by reviewing prior year tax positions and pursuing overpayments – for both income and non-income-based taxes.
- Companies should pay attention to the collateral state tax impact of business decisions made to generate or preserve cash, such as cash repatriations, sales of business units, or facility consolidations.
- Companies may also be compelled to seek credits and incentives they can monetize without taxable income, such as cash grants or refundable credits.

Contracting corporate earnings

- If taxable income decreases, companies may benefit from accelerating deductions into profitable tax years through elections or accounting method changes. In some states, this may be done on a state-only basis or opted-out of on a state-only basis.
- Companies may consider legal entity rationalization and/or updated transfer pricing to manage trapped income. Legacy state legal entity planning during an economic downturn is susceptible to “turning upside down.”
- Companies may benefit by re-evaluating state filing method elections, such as consolidation and water’s-edge/worldwide.

Changing interest rates

- The deductibility of interest expense is always an important consideration for state income tax purposes. If interest rates continue to rise, debt-related planning will tend to increase in significance.
- Companies will need to consider the more unfavorable section 163(j) limitation that came online in 2022, which no longer adds back depreciation and amortization to compute adjusted taxable income ("ATI"). State filing group differences can cause this limitation to vary substantially from the federal limit.
- State interest addback rule interpretations and challenges may take on added importance with higher interest balances in play.

Impact on State Tax Controversies & Litigation

- Timing of administrative refund claims and refund actions in court
  - Should you file the $100M refund claim or put it off until signs of recovery are on the horizon?
- Timing of administrative appeals
  - What is the tenor of dealing with state administrators on appeals during an economic downturn?
  - Has the state reduced spending? What is the impact on revenue agency personnel and processing of audits and appeals?
- Timing of settlement
  - Are states more inclined to give deeper discounts or fight harder to hold onto state tax dollars during an economic downturn?

Federal and State Legislative Activity

During an economic downturn, states frequently must balance competing interests of:

(1) addressing potential loss of revenue (e.g., from economic downturn and/or conformity to any federal tax relief legislation); and

(2) recognizing and providing relief (in a targeted way) to taxpayers that they view as being hit harder by the economic downturn.

Federal and State Legislative Activity (cont.)

Potential for stimulus/tax relief legislation. Examples:

- CARES Act
  - Federal legislation anticipating an economic downturn
  - Primary tenants:
    - Temporary increase to the business interest deduction limitation
    - Modified NOL carryback and limitation rules
    - Expansion of qualified investment property subject to 100% bonus depreciation
    - Reclassifying qualified improvement property (QIP) to make it eligible for a shorter depreciation life and therefore the 100% bonus depreciation
- Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act (P.L. 117-167)
- Inflation Reduction Act (IRA) (P.L. 117-169)

Federal and State Legislative Activity (cont.)

Key SALT issues when considering the impact of stimulus legislation like CARES, CHIPS, and IRA:

- Conformity: rolling, fixed, selective
- Retroactivity
- Varying state filing postures, e.g., separate company reporting, combined reporting, elective consolidated reporting

Other considerations:

- Many states have existing grants, credits, and incentives applicable to the type of investments contemplated by the IRA and the CHIPS Act.
- States may consider new legislation specifically addressing the technologies covered by the IRA and/or the CHIPS Act in the coming months.

Federal and State Legislative Activity (cont.)

Potential for defensive legislation. For example:

- New York's Fiscal Year 2022 Budget Bill
  - Temporary increases to tax rates on corporations, individuals, and tax credits for impacted industries
  - Temporary increased rate for and extension of the capital base tax through 2024
  - Elective pass-through entity tax to circumvent federal state and local tax deduction cap
- California's 2020 Budget Revise (A.B. 85)
  - Suspended the use of NOLs and capped business tax credit usage at $5 million for tax years 2022, 2021, and 2022
- District of Columbia's Corona Virus Support Emergency Amendment Act of 2020 (D.C. Act 23-326)
  - Limited NOL carryovers for corporations, unincorporated businesses and financial institutions

Federal and State Legislative Activity (cont.)

Other state legislation passed during economic downturns:

- Elimination of tax exemptions
- Broadening of tax bases
- New taxes and fees
- Combined reporting
- Tax amnesty programs

NOL Preservation

- Be aware of state-specific limits on the creation and use of NOLs
- Restructuring considerations
  - States may lack specific authority to transfer the target corporation's NOLs to the buyer in a tax-free reorganization (e.g., NOLs may be extinguished in the transaction). *See A.H. Robins Co., Inc. v. Director*, 182 N.J. 77 (2004).
- Case law may provide means to argue for the maintenance of a purchased company's NOLs. *See, e.g., Oliver's Laundry & Dry Cleaning Co. v. Ariz. State Tax Comm.*, 19 Ariz. App. 442, 508 P2d 107 (1973); *ThermatoolCorp. v. Dep't of Rev. Services*, 43 Conn. Sup 260, 651 A2d 763 (1994).
- Federal Separate Return Limitation Year ("SRLY") principles can apply at the state level but apply in scenarios not relevant for federal tax purposes.
  - For example, a state combined group may change to include other previously non-unitary companies; SRLY limitations may apply even though the federal group did not change.

Credits and Incentives

- Negotiating with state and local authorities during an economic downturn
- Stimulus-specific incentives
  - E.g., COVID-specific incentives to attract remote workers, CHIPS Act, IRA

Credits and Incentives (cont.)

- Opportunities for state financed credits/incentives may increase if unemployment rises
- For existing credits/incentives – review requirements to receive or obligation to clawback
  - Meeting headcount and investment requirements
  - Options to renegotiate numbers or delay time period in which numbers required to be met
  - Tax and business units should carefully work together re priorities
  - Financial Statement and publicity issues

Business Rationalization and Budget Issues

- Tax Department
  - Headcount
    - Reduction -- early retirement packages: loss of expertise
    - Centralization of tax function
    - Outsourcing
      - Loss of institutional knowledge
      - Transferring existing personnel to 3rd party contractor
      - Real long term cost savings?
  - Budgets
    - Reduction in other Departments affecting Tax – IT, Legal
    - Reduction of external consultant budgets

Business Rationalization and Budget Issues (cont.)

- Company wide
  - Business consolidation and division sales
    - Increase work for Tax Department – changes in unitary group; changes in intercompany pricing; business/nonbusiness issues on sales gains/losses
  - Automation efforts in exchange for reduced headcount
    - Could be opportunity for budget for new projects

Cash Issues

- Changes in emphasis on book versus cash income
- Moving cash around in enterprise
  - DRD issues
  - Repatriation
  - Entities created as part of tax planning – verify continued viability if challenged
- Selling non-core businesses to raise cash/reduce expenses
  - Unitary and business/nonbusiness issues
  - Planning for sale
- Audit and controversy settlement options

Important Considerations Regarding This Communication

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