Tax Insights
from State and Local Tax Services

The impact of COVID-19 on the state tax function

March 24, 2020

In brief

As our nation continues to respond to the threat of COVID-19, business operations have been disrupted and lives unsettled. Navigating state and local tax compliance and planning for the future always has been challenging. Now, businesses must take what was put into place post-federal tax reform and post-*Wayfair* and adapt it to a rapidly changing situation. Meeting this challenge will require a new vision of how we work and what we are trying to accomplish.

This Insight is intended to provide a framework for approaching these issues; we plan to follow up with additional tools and issue-specific Insights in the weeks ahead. For more information on responding to the impact of COVID-19, see COVID-19: What US business leaders should know.

In detail

Immediate concerns for operational continuity and compliance

The way we work is rapidly changing in the face of precautions undertaken by businesses and governments. For example, New York Governor Andrew Cuomo on March 20 announced an executive order requiring 100% of the workforce in the state to stay home beginning March 22 at 8 p.m., excluding essential services. Other jurisdictions have more stringent procedures in place, including 'shelter in place' orders.

The state and local tax function shares challenges facing business operations overall with keeping the function operational and connected to internal and external partners. However, the state and local tax function has unique features to consider when implementing an overall business and tax department plan for operational continuity.

One example is revising processes to handle the various notices received from multiple state and local jurisdictions. These revised processes must account not only for tax personnel working remotely, but also for staff that might receive the notices in various parts of the business organization. Another example is dealing with the widely varying compliance mandates in the states and localities, including paper filings and 'wet signature' requirements. State tax authorities may need to be approached individually to provide workarounds for filing documents where paper filing or obtaining return signatures is impractical (or impossible).

These and other changes to procedures for the state and local tax function must account for the technological limitations and legal requirements in the states and localities. Procedures and automations must be revisited and modified where needed to account for the changes in work processes and to maintain the organization's standards around security and documentation.

Compliance deadlines - state and local governments provide relief

Multiple states already have provided relief for compliance with state tax filing and payment deadlines. [Link to PwC tracking, which will be updated periodically with recent state actions.]

For example, the California Franchise Tax Board (FTB) on March 18 announced the state is postponing until July 15 the filing and payment deadlines for all individuals and business entities for 2019 income tax returns, 2019 income tax return payments, 2020 1st and 2nd quarter estimated payments, 2020 LLC taxes and fees, and 2020 non-wage withholding payments. Further, for taxes and fees administered by the California Department of Tax and Fee Administration (DTFA), including sales and use tax, requirements to file a statement setting forth the facts for a claim for relief are suspended for a period of 60 days for any individuals or businesses who are unable to file a timely tax return or make a timely payment as a result of complying with social distancing measures related to COVID-19.

Michigan is providing relief specifically related to its sales, use, and withholding taxes. The Michigan Department of Treasury is waiving penalties and interest for the late payment of tax or the late filing of the return due on March 20, 2020. The waiver will be effective for a period of 30 days; therefore, any return or payment currently due on March 20, 2020 may be submitted to the Department without penalty or interest through April 20, 2020.

IRS Notice 2020-18 issued on March 20 supersedes IRS Notice 2020-17. Under Notice 2020-18, the due date for filing federal income tax returns and making federal income tax payments due April 15, 2020, is automatically postponed to July 15, 2020. There is no limitation on the amount of the payment that may be postponed, and affected taxpayers do not have to file Forms 4868 or 7004. The relief provided is available solely with respect to federal income tax payments due on April 15, 2020 (including payments of tax on self-employment income), federal income tax returns due on April 15, 2020, and federal estimated income tax payments (including payments of tax on self-employment income) due on April 15, 2020. The Notice does not address returns or payments not due on April 15, nor does it address fiscal-year taxpayers. It is unclear in states and localities that have not provided specific guidance whether they will follow this filing and payment relief, and also if they will apply it to other types of state and local taxes due before, on, or after April 15.

Given the uneven nature of state filing and payment relief, state tax departments may consider drafting a standard request for penalty waiver putting forth the facts and circumstances leading to the failure to file and/or pay. Further, working with third-party vendors and advisors immediately to identify potential failures and creating a short-term mitigation plan will diminish the need to request such relief.

Conserving cash flow - a change in focus for the SALT function

The past two years in state and local tax have been consumed by modeling and responding to the state implications of federal tax reform and transforming the indirect tax function to meet the challenges of a post-*Wayfair* environment. Investments in technology and the insights they have produced must now be deployed to meet immediate business needs, including conserving cash flow.

For example, one way to increase cash flow is reducing or deferring the amount of estimated tax payments while complying with return and estimated tax payment requirements. However, strategies to reduce or defer estimated tax payments must include modeling to account for various income tax attributes that could be impacted by the strategy (e.g., IRC § 163(j) limitations, GILTI, dividends, etc.) and the company's overall income tax posture. Automations for estimated tax payments (as with automations for quarterly provisions) must be updated to account for this changing environment. Forecasts are changing dramatically, with significant changes in revenue and expense in different jurisdictions.

Delaying payment of sales and use taxes also can provide immediate cash flow benefits, and some states are providing taxpayers with this relief (for example, Michigan's 30-day relief for late payment penalties and interest cited above). Reverse sales and use tax audits can be undertaken to identify potential overpayments, but leveraging technology is key to understanding the overall tax position (including potential exposure) while capturing all the data to maximize and support refund requests. It is also important to consider that the use tax calculation should be a particular focus right now. Technology that can analyze the general ledger to assist with the accrual process and produce tax return ready data files is key to finding savings in this area.

In addition, companies should consider impacts to their credits and incentives profiles. For example, companies should

- As reduction of operational facilities occurs, consider retention incentives to factor into the cost evaluation of which facilities to keep operational.
- Secure statutory credits that may have gone unclaimed or been underclaimed on previously filed returns.
- Perform an EBITDA review for credits and incentives applicable to 2019 filings or 2020 operations to improve above the line cash flow in states like Georgia, Arizona, Arkansas, Tennessee, etc.
- Review prior incentives agreements to determine if/how milestones (e.g., job creation, investment thresholds, etc.) within such agreements may be impacted.
- Review credits and incentives the company anticipated would apply in the current tax year to evaluate whether such estimates remain accurate.
- Consider state and local jurisdictions' responses to the current environment as spring and summer legislative sessions progress (or reconvene).

Unclaimed property also could be an overlooked area for cash savings. Large companies often have hundreds of subsidiaries and a lengthy history of M&A activity, all factors that can make it easy to lose track of assets. As with tax, unclaimed property can help with cash flow if the company employs the right technology and process to maximize recovery.

The outlook on state and local tax policy

States continue to react to COVID-19, including by protecting state employees. State revenue departments have curtailed operations. State legislatures around the country are changing how they operate, including suspending sessions or cutting sessions short.

These legislative actions will have a significant impact on state and local tax policy -- either by leaving major policy decisions for future special sessions or next year's regular sessions, or by accelerating action on current proposals. An example of the latter course is the Maryland General Assembly's decision to end its session on March 18, and on the final day pass controversial legislation containing a first-in-the-nation gross revenue tax on digital advertising (H.B. 732). Cash-strapped states could see significant policy proposals, especially in special sessions later in the year when the budget impact becomes clearer.

While the amount of relief to states from the federal government remains uncertain, the state budgetary impact from COVID-19 is likely to be profound. For example, New York Comptroller Thomas DiNapoli on March 17 estimated a possible $4 to $7 billion decrease in the state's Fiscal Year 2021 revenues resulting from alternative scenarios of COVID-19 impact. States with greater reliance on personal income taxes are likely to see the greatest revenue shortfalls as a result of the recent stock market declines and increased unemployment.

The takeaway

State tax departments are being challenged by a simultaneous dramatic shift in operations and the economic impact of COVID-19. The investments made in technology and processes after federal tax reform and the *Wayfair* decision will help state tax departments meet these challenges and prepare for potential significant state tax policy changes to fill future budget gaps. Businesses should continue to monitor legislative and regulatory developments in the states, as well as at the federal and global levels, impacting state tax compliance and opportunities.

Let's talk

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