UPDATE FOR ACCOUNTANTS & FINANCIAL PLANNERS

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presented by

Mark W. Schweighofer, LL.M.
(301) 838-3233 direct
mschweighofer@steinsperling.com

Jeremy M. Vaida, LL.M.
(301) 838-3214 direct
jvaida@steinsperling.com

David S. De Jong, LL.M., CPA
(301) 838-3204 direct
ddejong@steinsperling.com

Eric J. Rollinger, JD, CPA
(301) 838-3330 direct
erollinger@steinsperling.com

Darla J. McClure, JD
(301) 838-3284 direct
dmcclure@steinsperling.com

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TAX TRAPS FOR FOREIGN ACTIVITIES

MARK W. SCHWEIGHOFER & JEREMY M. VAIDA

FOREIGN ACCOUNTS, FBARS, AND TAX REPORTING

- Schedule B, Part III ("did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?").
- FBAR Requirement - $10k or more in foreign accounts (in aggregate across all such accounts) at any time during the calendar year.
- Form 8938 (living in U.S.)
  - Single/MFS Filers – More than $50k in foreign accounts, as of December 31, or $75k at any point during the year.
  - Joint Filers – More than $100k in foreign accounts, as of December 31, or $150k at any point during the year.
- Form 8938 (living outside U.S.)
  - Single/MFS Filers – More than $200k in foreign accounts, as of December 31, or $300k at any point during the year.
  - Joint Filers – More than $400k in foreign accounts, as of December 31, or $600k at any point during the year.
  - Certain closely-held entities may have filing requirement as well.

	Form 8938, Statement of Specified Foreign Financial Assets	FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR)
Financial (deposit and custodial) accounts held at foreign financial institutions	Yes	Yes
Financial account held at a foreign branch of a U.S. financial institution	No	Yes
Financial account held at a U.S. branch of a foreign financial institution	No	No
Foreign financial account for which you have signature authority	No, unless you otherwise have an interest in the account as described above	Yes, subject to exceptions
Foreign stock or securities held in a financial account at a foreign financial institution	The account itself is subject to reporting, but the contents of the account do not have to be separately reported	The account itself is subject to reporting, but the contents of the account do not have to be separately reported
Foreign stock or securities not held in a financial account	Yes	No
Foreign partnership interests	Yes	No
Indirect interests in foreign financial assets through an entity	No	Yes, if sufficient ownership or beneficial interest (i.e., a greater than 50 percent interest) in the entity. See instructions for further detail.
Foreign mutual funds	Yes	Yes
Domestic mutual fund investing in foreign stocks and securities	No	No
Foreign accounts and foreign non-account investment assets held by foreign or domestic grantor trust for which you are the grantor	Yes, as to both foreign accounts and foreign non-account investment assets	Yes, as to foreign accounts
Foreign-issued life insurance or annuity contract with a cash-value	Yes	Yes
Foreign hedge funds and foreign private equity funds	Yes	No
Foreign real estate held directly	No	No
Foreign real estate held through a foreign entity	No, but the foreign entity itself is a specified foreign financial asset and its maximum value includes the value of the real estate	No
Foreign currency held directly	No	No
Precious Metals held directly	No	No
Personal property, held directly, such as art, antiques, jewelry, cars and other collectibles	No	No
‘Social Security’- type program benefits provided by a foreign government	No	No

OTHER INTERNATIONAL TAX FORMS

- Form 3520/3520A – Foreign Trusts and Gifts
- Form 5471– Foreign Corporations Acquired and Owned by U.S. Persons
- Form 5472– Domestic Corporations Owned by Foreign Persons—25% Threshold
- Form 8858 – Foreign Disregarded Entities
- Form 8865 – Foreign Partnerships
- Form 8621 – Passive Foreign Investment Companies (“PFICs”)

INTERESTS IN FOREIGN TRUSTS/RECEIPT OF FOREIGN GIFTS – FORM 3520/A

- Must be filed by any U.S. Person who:
  - Is considered the owner of a foreign trust (under the grantor trust rules);
  - Received a distribution from a foreign trust;
  - Received a gift/bequest of over $100,000 from a foreign individual or a foreign estate; or
  - Received a gift of over $15,601 (inflation-indexed item) from a foreign corporation or partnership.
- Filed at the same time U.S. Person's income tax return, but filed separately. Note: 3520A is earlier.
- Failure to File Penalty is greater of $10,000 or 35% of the distribution or gift received or 5% of the gross value of the portion of the trust's assets deemed owned by the U.S. Person.
- Failing to report an interest in or distribution from a foreign trust will keep the SOL on the entire return open (failing to report a foreign gift does not keep the SOL open on the income tax return).

WORD #1
APPLE

INTERESTS IN CERTAIN FOREIGN CORPORATIONS – FORM 5471

- Filed with U.S. Person's income tax return
- Very burdensome reporting depending on the category of filer (5 categories, with several additional subcategories)
- Failure to File Penalty:
  - $10,000 and escalates to $50,000 at 7 months late; and
  - 10% reduction of foreign tax credits otherwise available and additional 5% reduction for each 3-month period failure to file continues

INTERESTS IN CERTAIN FOREIGN CORPORATIONS – FORM 5471

- Significant changes in 2018
  - Substantially revised schedule J
    - The CFC’s accumulated E&P Schedule
    - Reported in functional currency
  - Addition of Schedule P
    - Used to report previously taxed income (PTI) of the U.S. shareholder
    - Requires a separate schedule for each U.S. Shareholder

INTERESTS IN CERTAIN FOREIGN CORPORATIONS – FORM 5471

- Tax Court development in 2023 – *Farhy v. Commissioner*, 160 T.C. 6 (2023)
  - Taxpayer owned two foreign corporations
  - For the 2003 through 2010 tax years, the taxpayer failed to report his interests in the two corporations on Forms 5471
  - The IRS notified the taxpayer of his failure to file Forms 5471, but the taxpayer never complied. The IRS assessed multiple penalties for each unreported corporation
  - Court ultimately ruled IRS lacks the statutory authority (under its reading of I.R.C. 6038) to assess Form 5471 penalties and therefore could not proceed with the collection of the penalties against the taxpayer
  - Penalties CAN be assessed, but only through a Department of Justice action, not administratively within the IRS
- Since the Tax Court ruling …
  - IRS has since appealed the case to Fourth Circuit where it awaits adjudication
  - Internally, IRS is continuing to prosecute Form 5471 penalties as if Farhy does not exist
  - Anecdotally, IRS is not viewing Farhy as a reason to compromise on 5471 penalties

FOREIGN BUSINESS INCOME – SUBPART F AND GILTI

- Passive income from CFCs (controlled foreign corporations) are taxed presently in the United States, even if not distributed to U.S. persons.
  - A foreign company is considered a CFC if more than 50% of either voting power or value is owned by a U.S. person.
  - Includes foreign dividends, interest, rents, and royalties, even if such income is not actually distributed to U.S. persons.
- GILTI expands Subpart F to include even active business income earned abroad.
  - HOWEVER: regulations clarified that GILTI will not apply to certain “high-tax” income, currently identified as income taxed at 18.9% or higher.
  - Thus, as a practical matter, most active business income earned abroad will not be subject to GILTI.
  - HOWEVER: income that does not fall under the “high-tax” or some other exception is subject to highly complex and onerous tax and reporting obligations.

FOREIGN EMPLOYEE V. FOREIGN IC

- U.S. person living abroad and working as an employee has wage income reportable on Line 1.
  - Essentially no different than wage earner in U.S.
  - **Watch Out**: Foreign retirement plans could be PFICs.
  - **Watch Out**: U.S. company that has an employee in foreign country will cause nexus in that country, causing a cascade of tax and reporting requirements in the foreign jurisdiction.
- Independent contractors will generally report income on Schedule C, flow through to Line 3 of Schedule 1.
  - Must check whether country where Taxpayer works has a Totalization Treaty with the United States (treaty which governs Social Security type payments).
  - Without such a treaty, U.S. independent contractors are required to fill out Schedule SE.
  - This will almost always result in double taxation.
  - Planning Tip: Formation of foreign entity.

PFICS AND FORM 8621

- What is a PFIC (passive foreign investment company)?
  - At least 75% of the corporation's gross income is "passive"—that is, derived investments or other sources not related to regular business operations; OR
  - At least 50% of the company's assets are investments, which produce income in the form of earned interest, dividends, or capital gains.
- Must be on the lookout for:
  - Foreign retirement accounts;
  - Foreign index funds;
  - Certain foreign financial instruments;
  - Certain foreign bank products.
- Required to file Form 8621
  - Labor intensive
  - Requires substantial amounts of information not easily obtained/obtainable

WORD #2
BANANA

FOREIGN NATIONAL SPOUSES

- *Inter vivos* transfers to non-resident alien spouse limited to $175,000 in 2023 (annually adjusted for inflation).
  - **Watch Out**: real estate purchases.
  - **Watch Out**: transfers into joint bank account.
- Transfers at death to non-resident alien spouses of U.S. property limited to $60,000 (unlimited for U.S. residents).
  - **Watch Out:** U.S. real property.
  - **Watch Out:** retirement accounts established while in U.S.
  - **Planning Tip:** some countries have Estate and Gift Treaties with U.S. that can mitigate some of the harshest results.
- Non-residents can elect to be treated as a U.S. residents.
  - **Watch Out:** such election will require non-resident spouse to report on a worldwide basis.
  - **Watch Out:** FBAR, PFIC, etc. rules will also apply.

REAL PROPERTY

- If held directly by an individual, no special international tax form.
  - If a rental property, would simply be reported on Schedule E, like domestic property.
- I.R.C. 121 personal residence exclusion available even for foreign held property.
- I.R.C. 1031 exchange cannot be used to exchange domestic property with foreign property.
- However I.R.C. 1031 can be used to exchange foreign property with other foreign property.
- **Planning Tip:** Use I.R.C. 121 to exclude U.S. personal residence gain to purchase foreign personal residence. Once in foreign jurisdiction, foreign property can be exchanged for other foreign property under 1031.

ESTATE AND GIFT TAX CONSIDERATIONS

- Estate tax exemption for non-resident aliens is very low, $60,000 with respect to U.S. situs property.
- Watch for situations where foreign nationals own U.S. real property directly or through a disregarded entity. Will be subject to estate/gift tax during life.
- **Planning tip:** Own real property through U.S. entity that is regarded (C corporation or partnership). If gifted during life, should avoid U.S. gift tax as not considered U.S. situs purposes. NOTE: The situs will switch upon death and the entity interest will be subject to U.S. estate tax.

MISCELLANEOUS ISSUES

- State Tax Consequences
  - Many states do not provide foreign tax credit
  - Several states have adopted special procedures to address offshore assets

- Don’t forget about the Net Investment Income Tax
  - Foreign tax credit will not offset NIIT

INTERNATIONAL COMPLIANCE SOLUTIONS

- Streamlined Domestic Offshore Submission
  - Only eligible to those who have timely filed tax returns, at least in the last three years
  - 5% Miscellaneous Penalty (based on highest value of assets on unreported forms during six-year lookback)
  - Requires:
    - Six years of FBARs
    - Three years of tax returns
    - Special form
    - Accompanying narrative

- Streamlined Foreign Offshore Submission
  - Eligible even to non-filers
  - No 5% Miscellaneous Penalty
  - Requires
    - Six years of FBARs
    - Three years of tax returns
    - Special form
    - Accompanying narrative

INTERNATIONAL COMPLIANCE SOLUTIONS (CONT.)

- Delinquent International Information Return Submission Procedures (DIIRP)
  - Eligible even to nonfilers
  - Technically no lookback period (though last six years is common practice, absent specific facts)
  - No 5% miscellaneous penalty
  - Less predictable than Streamlined
  - Must file full returns for all periods

WORD #3
STRAWBERRY

UNLOCKING KEY TAX ELECTIONS

DAVID S. DE JONG

83(b)

The section 83(b) election allows a recipient of stock, an LLC interest or other property to pay taxes on its value at the time of receipt irrespective of the initial restrictions on "enjoyment."

- Without the election, the taxable event would arise when the restrictions lapsed.
- If the election is made, the valuation is made without regard for the restrictions.
- The election must be filed with IRS and the employer within 30 days after receipt of the restricted property.
- Even if the election results in no income, the election must be filed and the taxable event causing zero income should be shown on the tax return.

83(b) CTD.

- The 83(b) election makes the most sense when there is little or no current value. If there is significant value, it will still make sense when the value of the interest is almost certain to increase in the coming years.
- The 83(b) election may not make sense if the recipient cannot afford to pay the taxes, if the company may go down in value or if the worker may leave before the restrictions lapse.

213

Medical expenses paid out of the estate in the year following death can be deducted on the final 1040 of the individual or can be deducted as a claim against the estate.

- The election to deduct unpaid medical bills on the final 1040 is made by attaching a statement to the final return

213 CTD.

- Where estate tax liability exists, the deduction on Form 706 will be more valuable than on Form 1040.
- Especially in the case of individuals who die late in the year after considerable income has been earned or in the case of decedent returns filed jointly with a surviving spouse with income, the medical deduction for final expenses may do little good.

338(h)(10)

The 338(h)(10) election allows a stock sale for legal purposes to be treated as an asset sale for tax purposes.

- Target company must be an S-corporation or a member of an affiliated or consolidated group of corporations.
- Purchaser must be a corporation making a qualified stock purchase of at least 80 percent of the target's stock.

338(h)(10) CTD.

- Purchaser and all stockholders of target must agree to the election.
- File Form 8023 with IRS by the 15th day of the 9th month after closing. It is signed by all parties whose consent is required. Ideally Buyer obtains an executed Form 8023 at Closing.

338(h)(10) CTD.

- Purchaser gets to step up tax basis in target's assets to fair market value with write-offs based on current expensing, bonus and regular depreciation rules.
- In most transactions, much of the value is in the goodwill and will be written off over 15 years.

338(h)(10) CTD.

- Seller will want to avoid allocations which would create gain such as inventory, accounts receivable and depreciation recapture.
- Inasmuch as the benefit to the Purchaser of the election is greater than the detriment to the Seller, the Purchaser may be asked to gross up the price to cover the added taxes to the Seller.

338(h)(10) CTD.

- Maryland apparently requires the payment of sales tax based on the allocation to fixed assets.
- A variation on the 338(h)(10) election is the 336(e) election where the acquirer is not a corporation. File the election with IRS by the 15th day of the third month following the closing.

SECTION 408

In most instances, it makes sense for the surviving spouse to roll over an inherited retirement plan interest or IRA into the surviving spouse's own name.

- This usually slows the required minimum distribution as it is then based on the combined life expectancy of the surviving spouse and a deemed beneficiary ten years younger (or actual beneficiary more than ten years younger).
- If funds will not be needed, consider conversion to a Roth with payment of the taxes from non-retirement monies.

SECTION 408 CTD.

- An exception to the general rule is when the surviving spouse is under age 59 ½ and funds may be needed.
- When the surviving spouse reaches 59 ½, the rollover can then be made with penalty-free access to funds.
- Another exception to the general rule is when the surviving spouse is much older (at least age 73) and distributions would need to commence on a rollover but not decedent account.

SECTIONS 441/444

A C corporation (other than a personal service corporation) has a complete choice of fiscal year.

- S corporations, entities taxed as a partnership and personal service C corporations must use a calendar year unless they can show a normal business year ends on the last day of another month.

SECTIONS 441/444 CTD.

- Flow through entities and personal service corporations may also elect a September, October or November yearend by making a Section 444 election on Form 8716 by the earlier of the 15th day of the fifth month of the new taxable year or the original due date of the first tax return in the new fiscal year.
- A section 444 election rarely gives results worth the complications as flow through entities must file Form 8752 to make a "required payment" and personal service corporations must make "minimum distributions" (Schedule H, Form 1120) to shareholders during the deferral period.

SECTIONS 441/444 CTD.

- Simplicity dictates that an estate that can close within 12 months should use a single fiscal year. However, if no distributions are taken in the early months of an estate, lower taxes may result from cutting off the initial fiscal year before the estate reaches the higher brackets.
- Maximum deferral may call for a January 31 yearend.

SECTION 446

For those not required to use accrual accounting, cash basis reduces net income where receivables will consistently exceed payables.

- If payables will normally be larger, use of accrual accounting will reduce net income.
- If inventories are material, they must be matched with revenue irrespective of whether accrual accounting is otherwise required.

SECTION 469(c)(7)(A)

The default rule is that each real property is treated as an independent activity for purpose of the material participation requirement unless an election is made by a real estate professional to treat the properties as a single activity. As meeting the material participation requirement for each property is unrealistic, the election normally should be made.

- A real estate professional must have over 750 hours in the activity and the hours must exceed the hours in all other activities combined.
- File a statement with the original return for the year of first election. Late elections are permitted for cause.
- Revocation requires showing a material change in facts and circumstances.

SECTION 469(c)(7)(A) CTD.

- The advantage of the election is that potential passive losses become nonpassive with the election.
- The disadvantage is that disposition of a single property will not dislodge existing passive pre-election losses on a property.

SECTION 645

The Section 645 election allows the Personal Representative of an estate and the Trustee of a trust to elect to be treated as one for tax purposes. The election is made on the first 1041 trust return.

- This allows the Trust income to be reported on other than a calendar year.
- The only reason not to make the election would be in the event of conflicts between the estate and the trust.

SECTION 645 CTD.

Other advantages of the section 645 election include:

- Estates get a charitable deduction for amounts set aside but not yet turned over to charities.
- Estates are exempt from estimated tax payments for two years.
- Estates can hold S corporation stock through a lengthy administration period and are not limited to two years.

SECTIONS 706/1377

When there is a mid-year change in percentages, the books are cut off in the case of an entity taxed as a partnership; however, the partners in the partnership or otherwise can agree on proration. In contrast, in an S corporation, a proration is done on a mid-year change in ownership unless there is an election to cuff off the books.

- There can be a huge swing in reporting of income based on the decision. Often the methodology is preordained in the governing documents.

SECTION 754

A section 754 election is made by an entity taxed as a partnership, typically upon the admission of a new member by purchase or inheritance in order for the new admittee to receive what is, in effect, additional inside basis for depreciation and/or amortization based on a higher value of assets than currently shown on the books.

Inasmuch as a revocation (Form 15254) requires good cause, consider that a 754 election in place could work to a disadvantage in the future.

SECTION 754 CTD.

- The 754 election is made by filing a statement with the tax return for which the election is first desired. The signature requirement was recently dropped.
- Most of the adjustment for a 754 election may be to goodwill with its 15-year amortization. However, with expensing and (until 2023) 100 percent bonus depreciation, recent 754 elections have given added basis for depreciation.
- The Section 754 election is not available in an S corporation and is a major reason why LLCs have become the entity of choice.

SECTION 2010(c)

Section 2010(c) permits a decedent estate to make a portability election which generally allows the surviving spouse to tack on the unused exemption of the predeceasing spouse on to the exemption of the surviving spouse.

- Timely filing of the 706 (within 15 months, if extended) at the first death is required when an estate tax return must be filed.
- If a 706 is not required, it may be filed to elect portability within five years of death (file MET-1 in Maryland as well within the five years).

SECTION 2010(c) CTD.

Disadvantages of portability vis-à-vis use of a disclaimer trust:

- Loss of portability if the surviving spouse remarries and the new spouse predeceases.
- Records related to the estate of the first spouse must be retained indefinitely.
- Credit shelter trusts provide asset protection and remove appreciation from the surviving spouse’s estate.

2053

Administration expenses may be deducted on Form 706 or Form 1041 but not both. To claim administration expenses on Form 1041, a statement must go on the 1041 within the limitations period that states that the deductions have not been allowed on the 706.

- In general, claim administration expenses on the 706 if there is estate tax liability and otherwise on the 1041.
- Different beneficiaries may benefit from the choice if there is both an estate and income tax liability.

8832

Form 8832 is used for a limited liability company to elect to be taxed other than as a sole proprietorship if it has one member or as a partnership if it has two or more members.

- If the entity is going for tax purposes from a sole proprietorship or a partnership to an S corporation, Form 2553 may be filed in lieu of Form 8832.
- If the LLC is currently taxed as a corporation the form may be used to convert to an unincorporated entity for tax purposes.

8832 CTD.

- Be very careful in “unincorporating” in any format as a corporate liquidation for tax purposes can result in significant tax liability (the value of distributed assets including institutional goodwill is compared with the basis in the stock).
- It is very difficult to draft an Operating Agreement for an entity taxed as a corporation especially an S corporation as it requires the use of LLC terms but corporate tax principles.

8832 CTD.

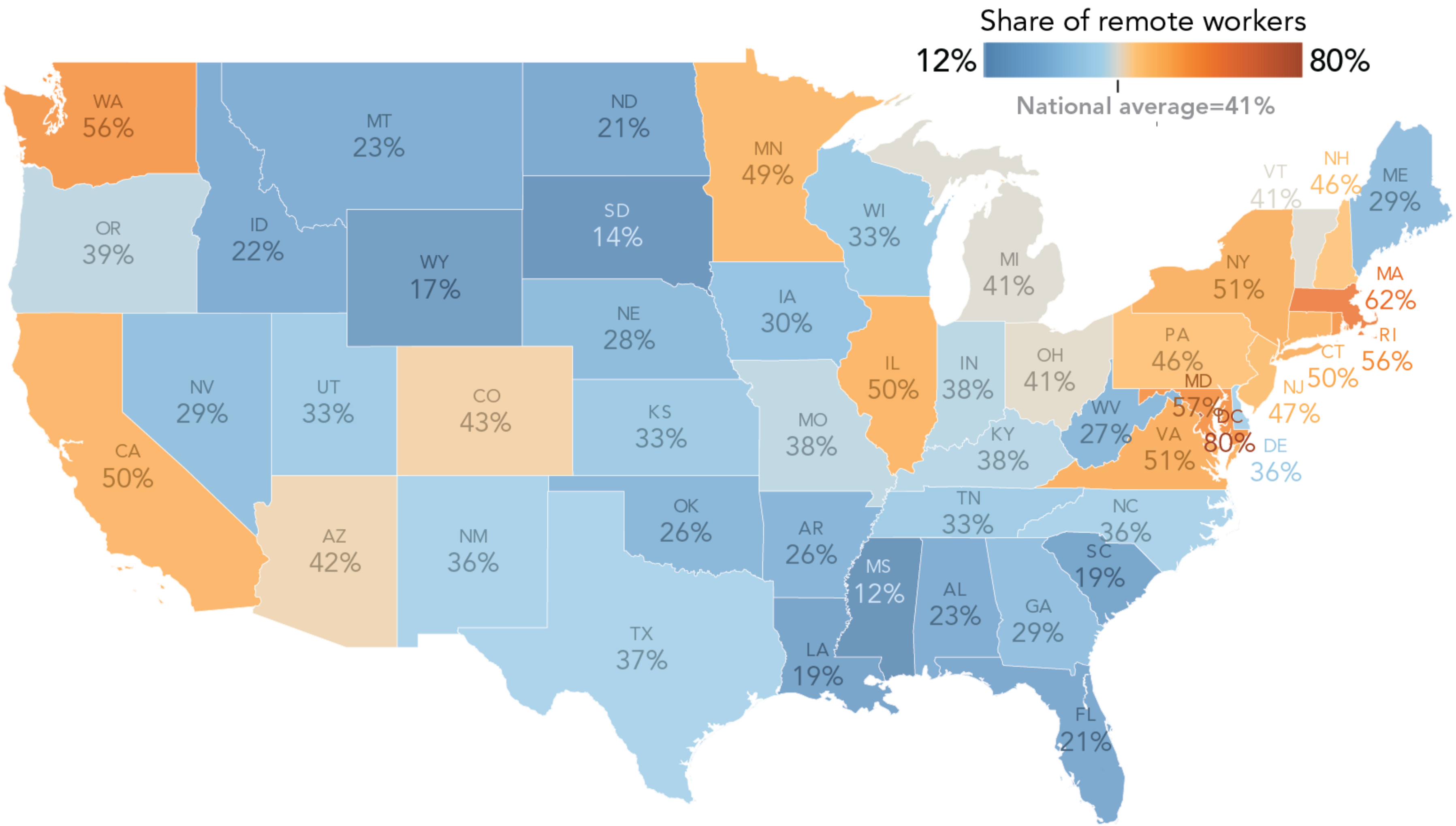
- File Form 8832 at any time. If no effective date is shown, the filing date is the effective date. A date may be chosen up to one year in advance or retroactive for 75 days.
- File Form 2553 up to one year in advance or up to 2 ½ months retroactively.
- Late relief is available from IRS.

ISSUES WITH REMOTE WORKERS

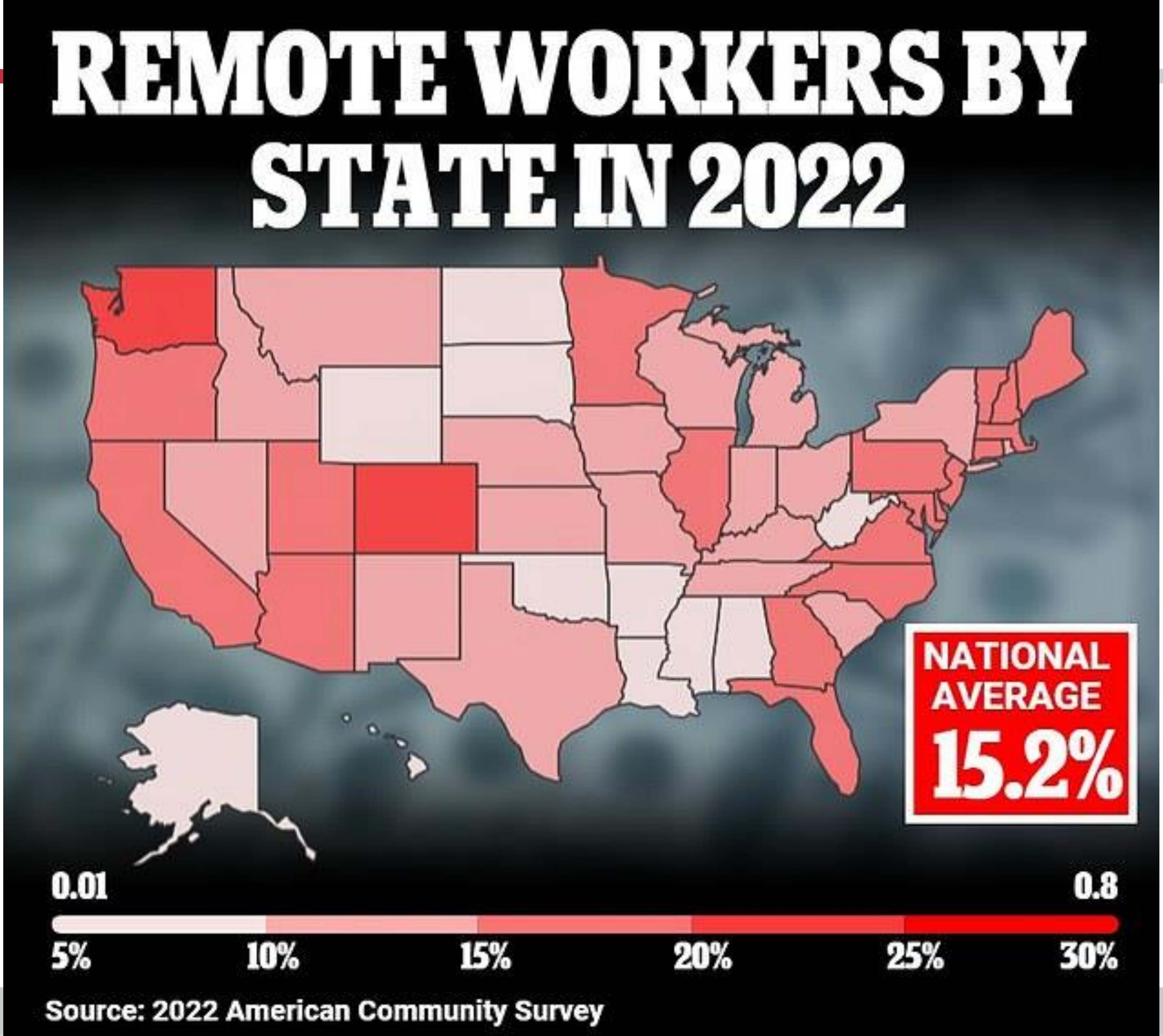
DARLA J. McCLURE & ERIC J. ROLLINGER

Rates of remote work vary widely across US states

Share of workers in professional and office occupations aged 25 to 54 who shifted to working from home because of the pandemic, January 2021

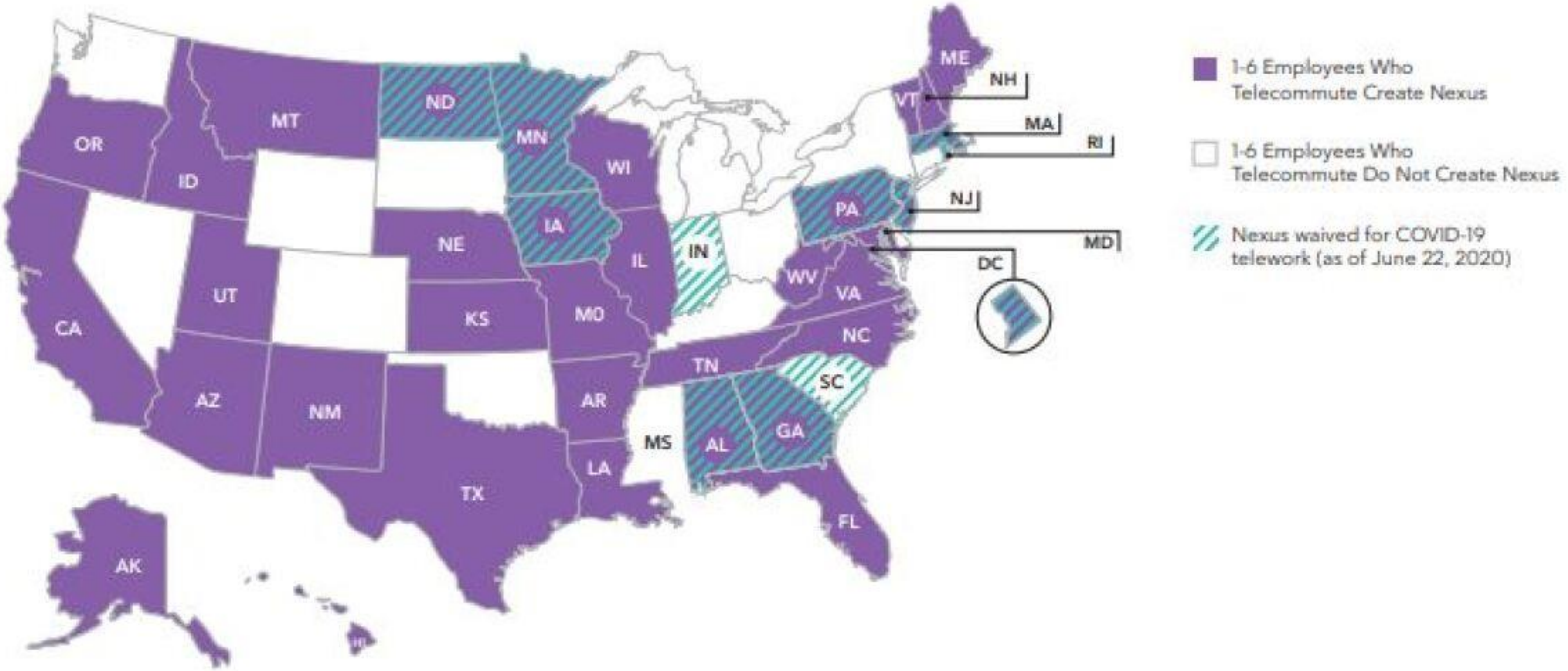


Source: The Conference Board using microdata from the Current Population Survey


REMOTE WORKERS BY STATE IN 2022
NATIONAL AVERAGE
15.2%
0.01
0.8
5%
10%
15%
20%
25%
30%
Source: 2022 American Community Survey

ARE YOUR REMOTE WORKERS REMOTE ENOUGH TO AVOID STATE TAXES AND NEXUS?

Will Telecommuting Employees Create Nexus?



NOTE: DC and NYC are treated as states for purposes of this chart. OH, NV, SD, WA, and WY do not impose a corporate tax based on income. CO, DE, MI, NY, NYC, OK, and SC did not participate in this portion of the survey. As a result, these 12 states are not included in this chart.

Source: https://www.accountingtoday.com/news/states-see-employee-telecommuting-as-a-way-of-creating-tax-nexus-amid-coronavirus

WHAT IS NEXUS?

- Nexus (i.e. Constitutionality)
  - Historical Background
    - "[S]ome definite link, some minimum connection between a state and the person, property, or transaction it seeks to tax." Allied-Signal, Inc. v. Director, Div. of Taxation, 504 US 768, 777 (1992).
      - Need minimum connection with the person
      - Need minimum connection with the activity
    - In Quill Corp. v. North Dakota, the Supreme Court held that the Commerce Clause (in contrast to the Due Process Clause) limited states' power to impose sales and use tax collection obligations on out-of-state sellers to those with physical presence in the state. Quill Corp. v. North Dakota, 504 US 298 (1992).
    - But in South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018), the Court reversed its position and found that physical presence is not required.
      - The first prong of the Complete Auto test simply asks whether the tax applies to an activity with a substantial nexus with the taxing State. "[S]uch a nexus is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction." South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).
      - Has opened the floodgates to the concept of "Economic Nexus" – where the only connection a business need have with a state is to derive income from sources within that state.

ECONOMIC NEXUS

- Virtually all States that have an income tax apply economic nexus.
  - No specified threshold (though that may be changing) (33 States, including MD, DC, and VA)
  - Others require some kind of economic threshold (similar to sales and use tax standard, see supra) (12 States)
  - Only DE and MO require a physical presence
  - **Rule of Thumb - $100,000 in gross receipts or more sourced to a state**
- Can apply at the city level
- Independent Contractors
  - In Tyler Pipe Indus., Inc. v. Washington Department of Revenue, the Court held that Washington had sufficient nexus with an out-of state manufacturer to satisfy constitutional concerns, even though the taxpayer had no office, property, or employees in the state. The manufacturer did, however, use independent contractors in the state who acted daily on its behalf to solicit sales, call on customers, and maintain and improve the seller's name recognition, good will, and individual customer relations. Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232 (1987).

NEXUS AND INDEPENDENT CONTRACTORS

- In Tyler Pipe Indus., Inc. v. Washington Department of Revenue, the Court held that Washington had sufficient nexus with an out-of state manufacturer to satisfy constitutional concerns, even though the taxpayer had no office, property, or employees in the state. The manufacturer did, however, use independent contractors in the state who acted daily on its behalf to solicit sales, call on customers, and maintain and improve the seller's name recognition, good will, and individual customer relations. Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 US 232 (1987).
- The mere fact that an out of-state corporation has hired an independent contractor to provide it with goods or services cannot be the basis for assertion of jurisdiction over the out-of-state enterprise. **The Court has never suggested that a contractual relationship with an unrelated third party in and of itself can provide the state with a basis for asserting jurisdiction over an out of-state taxpayer**.
- On the other hand, when "the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales," Tyler Pipe suggests that the state does have the requisite nexus to impose tax obligations over the out-of-state taxpayer.
- **Basically, can't get away from nexus just because you call someone an independent contractor versus an employee.** "The labeling of the salesmen as 'independent' was not controlling, it was held, because it would 'open the gates to a stampede of tax avoidance' if such a formal contractual designation were allowed to make a constitutional difference."

IN-STATE PARTNERS

- In most states, a general partner in a partnership doing business in the state is subject to the state's income or franchise tax on its distributive share of the partnership income attributable to the state, even if the partner has no other ties to the state.
- This has largely applied to limited partners as well. However, even in the cases where limited partners were not found to cause partnership nexus, it was because the limited partner was not considered to be "doing business" in the State, not that the State did not have the right to tax them (AL, CA, LA, and TN).
- In short, **any partner that is "doing business" in a State will enable that State to claim nexus over the partnership and a general partner's mere residence in a State will be sufficient.**

ECONOMIC NEXUS IN THE DMV

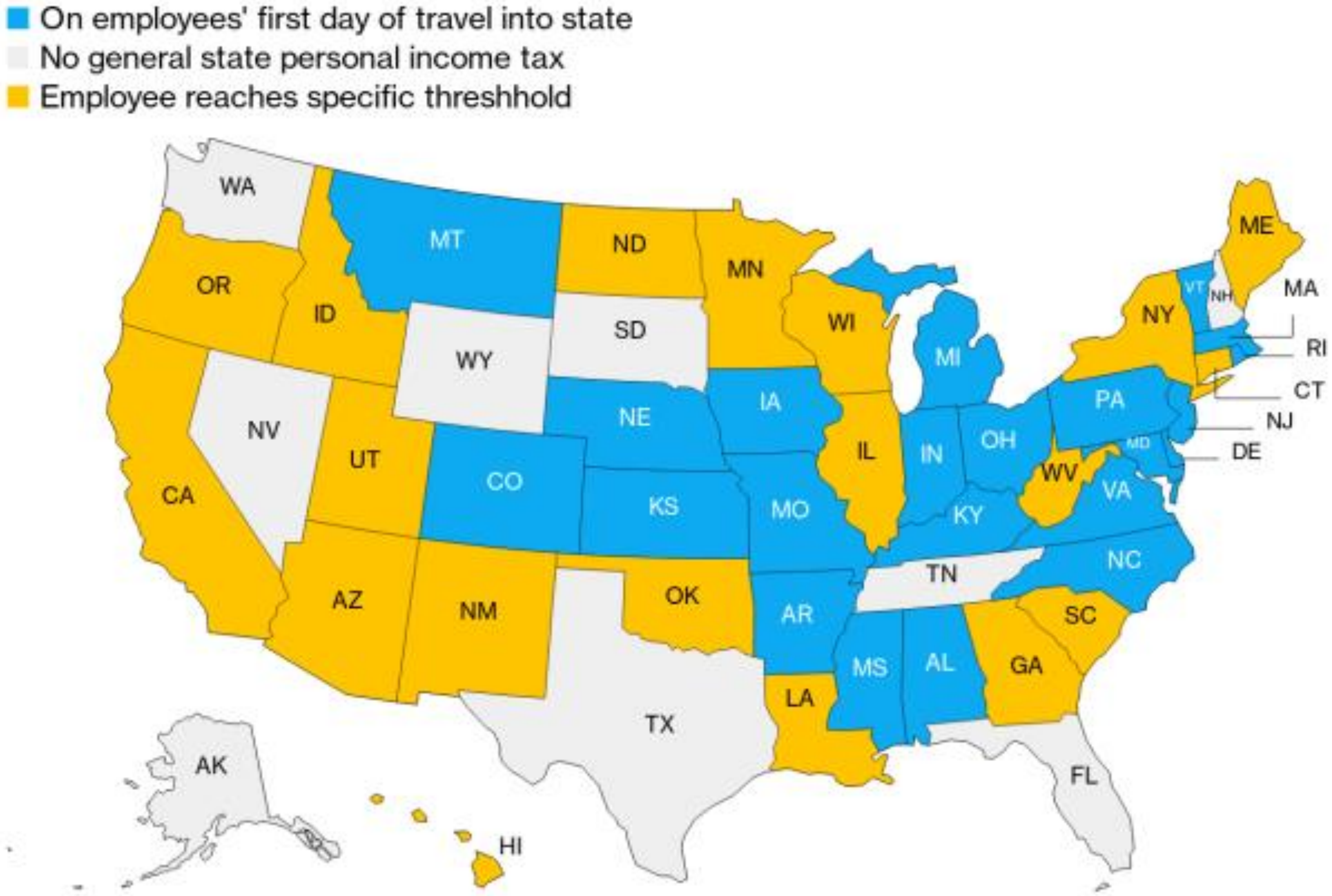
- DC
  - The District of Columbia applies an economic presence nexus standard. Under the plain language of District law, a taxpayer has nexus if it has income from District sources. Regulations assert nexus based on income from services performed in the District, or from investments or other capital employed in the District. Little interpretive guidance is provided on this broad standard. (D.C. Code Ann. § 47-1810.01(a) ; D.C. Mun. Regs. 9 § 121.3)
  - The District of Columbia has not adopted a factor presence standard or in-state gross receipts standard but does assert nexus based on economic presence. (D.C. Code Ann. § 47-1810.01(a) ; D.C. Mun. Regs. 9 § 121.3)
- Maryland
  - Maryland applies an economic presence nexus standard. Under the plain language of Maryland law, a taxpayer has nexus if it has income or losses attributable to in-state sources. Maryland has asserted corporate income tax nexus against out-of-state holding companies and other subsidiaries lacking economic substance in the state.(Md. Code Ann. Tax-Gen. § 10-810(b) ; Maryland Administrative Release No. 2, , 09/01/2009)
  - Maryland has not adopted a factor presence standard or in-state gross receipts standard (Maryland Administrative Release No. 2, , 09/01/2009)
- Virginia
  - Virginia applies an economic nexus standard. Under the plain language of Virginia law, a taxpayer is subject to the corporate income tax if it derives income from Virginia sources. The Department of Taxation asserts nexus over a corporation that has at least one positive apportionment factor, resulting in the possibility of a business having economic nexus based on sales into Virginia. (Va. Code Ann. § 58.1-400 ;Va. Admin. Code 23 § 10-120-90(G)(1) ; Va. Admin. Code 23 § 10-120-70 ; Virginia Public Document Ruling No. 14-62, , 05/06/2014; Virginia Public Document Ruling No. 09-81, , 05/26/2009)
  - Virginia also applies a factor presence standard. Under the plain language of Virginia law, a taxpayer is subject to the corporate income tax if it derives income from Virginia sources. The Department of Taxation asserts nexus over a corporation that has at least one positive apportionment factor, resulting in the possibility of a business having economic nexus based on sales into Virginia. (Va. Code Ann. § 58.1-400 ;Va. Admin. Code 23 § 10-120-90(G)(1) ; Va. Admin. Code 23 § 10-120-70 ; Virginia Public Document Ruling No. 14-62, , 05/06/2014; Virginia Public Document Ruling No. 09-81, , 05/26/2009)

CONSEQUENCES OF ESTABLISHING NEXUS

- Must register with the state and/or city
- Must comply with all tax obligations including:
  - Income tax
  - Gross Receipts Tax
  - Franchise Tax
  - Sales and Use Tax
  - Other Excise Taxes

ARE WITHHOLDINGS AND TAXES REQUIRED TO BE PAID TO WORKERS HOME STATE OR COMPANY LOCATION?

When Must a Nonresident Employer Withhold?



Sources: Council on State Taxation (COST), American Payroll Association (APA), Mobile Workforce Coalition
For general guidance, not compliance. May differ from employees' requirements.

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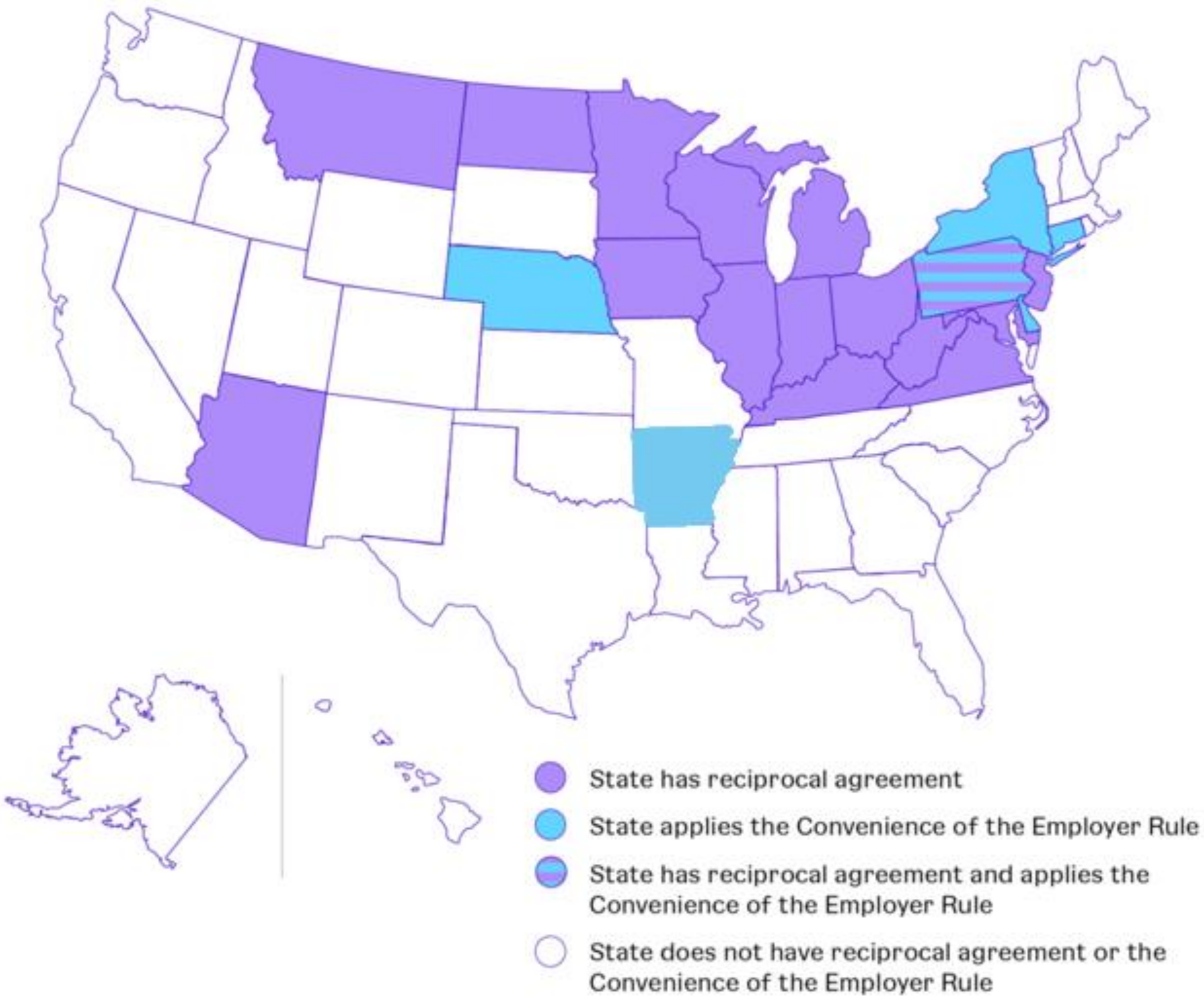
RECIPROCITY AGREEMENTS

- Typically, states enter into reciprocity agreements with their neighbors for the purposes of state income tax withholding
- This prevents commuters from being taxed in their place of work, even if they live across the border in another state
- Generally, only applies to border states, thus bringing in remote employees to the home office COULD give rise to a non-resident income tax requirement for such employees

STATE TAX WITHHOLDING: OUT-OF-STATE EMPLOYEES



PATRIOT

CONVENIENCE OF THE EMPLOYER RULE

- Wages paid to an employee are sourced to the employee's assigned work state (e.g., where the company is headquartered or maintains a brick-and-mortar facility) unless the work performed outside of that state is due to a business necessity
  - 6 states:
    - New York
    - Delaware
    - Nebraska
    - Pennsylvania
    - Arkansas
    - Connecticut (on a reciprocal basis)

UNEMPLOYMENT INSURANCE

- For employees who work in multiple locations, all states adhere to the Department of Labor's waterfall analysis.
  - https://oui.doleta.gov/dmstree/uipl/uipl2k4/uipl_2004a1.htm
- Four methods (only go to the next if the prior does not apply):
  - Localization of service
  - Base of operations
  - Direction and control
  - Residence

UNEMPLOYMENT INSURANCE

- Localization of service – Employee works almost exclusively in a single state, only going to another state on a temporary basis
- Base of operations – Employee's service is not localized in one state, but also performs services where the company's base of operations is located
- Direction and control – Employee's service is not localized in one state and does not work at headquarters, but takes direction from headquarters
- Residence – Employee's service is not localized in one state, does not work at headquarters, and does not take direction from headquarters

OTHER CONSIDERATIONS

- Generally, employees working remotely are subject to the laws of the state where they work. Employers could become liable for diverse state benefit programs or mandates such as:
  - Minimum Wage
  - Workplace Notices
  - Garnishment Restrictions/Limits (50% - 65% of disposable earnings per Consumer Protection Act 15 USC §1673(b) or 50% of gross per DC § 16-577)
  - Leave Requirements (paid and unpaid)
  - Anti-Discrimination Laws
  - Privacy, Confidentiality, and Other Restrictive Covenants
  - Reimbursement of Work Expenses
  - FMLA Considerations