Domestic and Multistate Tax Update

42nd Annual TEI-SJSU High Tech Tax Institute

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Tax updates for high tech not covered elsewhere in 42nd Annual High Tech Tax Institute

Disclaimer:

Educational updates; not intended to be taken as tax advice.

Reminder of §162(m) Change from P.L. 117-2 Effective For Tax Years Beginning After 12/31/26

- SEC. 9708 of American Rescue Plan Act (ARPA) (P.L. 117-2; 3/11/21) expanded definition of "covered employee" at §162(m) limit on certain excessive employee compensation to include (C) 5 highest compensated employees for tax year who are not already a covered employee under:
  - (A) CEO, CFO
  - (B) employee whose comp is required to be reported to shareholders under SEC Act of 1934 because among 3 highest compensated officers
  - Unlike (A) & (B) employees, 5 other highest compensated (C) do not continue to be limited unless fall under (A), (B) or (C) for the year.
- ***Observation***: IRS has Audit Technique Guide on §162(m) dated 9/4/24.

Updated Procedures for Accounting Method Changes for R&D under TCJA & OBBBA – Rev. Proc. 2026-32 (9/4/26)

Modifications to method change procedures (Rev. Proc. 2025-23) to comply with OBBBA changes to §174 and §174A → §481(a) adjustment might be limited to expenditures in tyba 12/31/21 and before 1/1/25. → If change results in negative §481(a) adjustment taxpayer may instead use cut-off basis (no §481(a) adjustment and just apply new method once adopted).

Also addresses changes for computer software, §195, §248, §709, others. → Need to read along with Rev. Proc. 2025-23 as RP 2026-32 is making changes to it. → https://www.irs.gov/pub/irs-drop/rp-26-32.pdf

R&D Tax Credit Partially Allowed – *Smith, et al*, TC Memo 2026-50 (6/16/26)

- IRS disallowed research tax credits for
  - 2008 - $3.1 million
  - 2009 – 4557,455
  - 2010 - $515,463
- At trial, examined 6 sample projects.
- LLP involved in architecture including for net-zero energy buildings and "supertall" buildings.
- "design process did not follow a traditional linear approach but integrated a holistic approach that engaged all elements of the project at the very beginning."
- Case provides lots of details on all 6 projects including costs.
- Issue – was this funded research ineligible for credit?
- https://dawson.ustaxcourt.gov/case-detail/13382-17

Smith, et al, TC Memo 2026-50 (6/16/26) - continued

- Funded research (§41(d)(4)(H) & Reg. 1.41-4A(d))
  - Excludes from qualified research, "[a]ny research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity)." Section 41 does not define the term "funded.""
  - Regs – 2 factors to determine if research is funded:
    - Not funded if amounts paid are contingent on success of the research (did taxpayer bear the financial risk of failure?)
    - Funded is taxpayer doing the research retains no substantial rights in the research.
  - Look at contracts to determine if funded.
- *Loper Bright* consideration because funded research not defined in IRC – does court agree with IRS interpretation in regs?
  - S argued reg is not best interpretation of §41(d)(4)(H).
  - Better to use ordinary meaning in dictionary.
  - Court upheld regs as tested and in line with congressional intent and an exercise of authority under §7805.

Smith, et al, TC Memo 2026-50 (6/16/26) - continued

- Regs valid and court applies the 2 tests:
- Was payment contingent of success of the research?
  - Who at risk if research fails
  - Looked at each contract for financial risk. A few examples:
    - Atrium City Tower found "no express terms" that S would accept responsibility for producing the product. Also show that S would be paid regardless of result.
    - ETA Star contract's termination clause said S would only be paid for performance to date if terminated. Court noted that this potential loss of full fee is not the type of financial risk noted in regs.
  - Examined contracts regarding substantial rights.
    - Some indicated S retained copyright rights.
- Conclusions:
  - Payments not contingent on success of the research for any of the contracts.
  - 4 of 6 projects, S retained substantial rights.
  - Research partially funded – relevant in determining status of all of the projects.

Smith, et al, TC Memo 2026-50 (6/16/26) - continued

- Final issue – was partner compensation reasonable as required under §174(e)?
- Varying tests for reasonable comp. Appeal here would go to 7th Circuit so court applied its "independent investor" test.
  - "if investors obtain returns above what they should reasonably expect, a manager's salary is presumptively reasonable."
  - Court found comp was reasonable.

R&D Planning

- OBBBA
  - Separates foreign (§174) and domestic (§174A) R&D
  - Foreign – must capitalize and amortize over 15 years
  - Domestic – expense unless elect to capitalize over 5 years and amortize when first realize benefits
    - Can also make 59(e) election to capitalize all or part and amortize over 10 years
      - Greater flexibility than elective 5-year amortization
    - Transition rule: Can expense unamortized domestic R&D before 2025 on 2025 return or ratable for 2025 and 2026
      - See Rev. Proc. 2025-28.
    - Watch for corporate AMT applicability of expensing domestic R&D

R&D Planning

- Recordkeeping for research tax credit and Form 6765
  - Draft instructions at 2/6/26 [link]
    - Section G, Business Component Information – required for 2026 (optional for 2025)
  - Link to form

Section G—Business Component Information. Complete lines 49(a) through 49(f) for each business component you are required to report. See instructions. Attach additional sheets if necessary to capture all business components.

BC	49(a) EIN of the controlled group member conducting the research activities on this business component	49(b) Controlled group member's principal business activity code	49(c) Business component's name or unique alphanumeric identifier (see instructions)	49(d) Business component type (select one from available options)
1				
2				
3				
4				
5				
6				
7				
8				
9				
10				
11				
12				
13				
14				
15				

BC	49(e) Software (if applicable, select from the available options)	49(f) Describe the information sought to be discovered. Use the space provided.
1		
2		
3		

TREASURY/IRS AND OMB USE ONLY DRAFT December 12, 2024

Form continues and also requires direct wages, direct supervision wages, direct support wages, cost of supplies, rental or lease costs of computers, contract research expenditures.

IRS Expands Features for Business Tax Accounts – FS-2026-11 (July 2026)

- "Users now have access to an expanding library of digital IRS notices. Recently added notices include
  - CP081B, We May Have a Refund for You, CP211A, Application to file extension of time approved
  - CP134R, Federal tax deposits discrepancy — Due a Refund
- Designated officials can now download an EIN verification notice, Notice CP575, Notice of New Employer Identification Number, which can be used instead of Letter 147C, EIN Previously Assigned, at banks and financial institutions.
- Eligible taxpayers can also submit payments for an Offer in Compromise to settle tax debts for less than full amount owed."
- https://www.irs.gov/newsroom/summer-2026-expanded-features-for-business-tax-account

Loper Bright – Keysight Technologies, Inc. & Subs., No. 25-137 (Fed Cls, 7/2/26)

- Opening statement: "When Chevron fell, so too did the presumption that statutory ambiguity favors the agency. … Loper Bright unambiguously reassigned interpretive authority to the courts but left largely unresolved the methodological question of how that authority is to be exercised. …The Court now grapples with that question. … The Court finds that Congress did not confer discretion to the Treasury to interpret the underlying statute."
- Deals with interpretation of GILTI, a type of income that after TCJA must be reported even if not repatriated to US. TCJA created issue between calendar and fiscal year taxpayers.
- K argues that w/o reg, it could include §197 deduction in GILTI. [1.951A-2(c)(5)]
- IRS argues had authority to draft reg per §7805(a).
- https://ecf.cofc.uscourts.gov/cgi-bin/show_public_doc?2025cv0137-70-0

Keysight Technologies, Inc. & Subs., No. 25-137 (Fed Cls, 7/2/26) - continued

"*Loper Bright* specified that courts may "seek aid from the interpretations of those responsible for implementing particular statutes." [*Skidmore* deference]

Weight of IRS guidance depends on:

- How thorough they are.
- Valid reasoning.
- Consistency with earlier and later pronouncements.
- Factors that give power to persuade such as per IRS expertise on the topic.

But "Court is the final arbiter and interpreter of statutes, particularly when they are ambiguous."

Court finds general authority to draft reg under §7805, "standing alone, is insufficient to supply the requisite authority."

- Purpose of broad delegation of authority at §7805(a) is to allow IRS "to issue regulations to ensure application of the law matches Congress's unexpressed intent"
- To give too much weight to §7805 "would invalidate *Loper Bright* itself."

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Keysight Technologies, Inc. & Subs., No. 25-137 (Fed Cls, 7/2/26) - continued

Also, if §7805 were so broad, there would be no need for Congress to ever specify in a Code section that the IRS issue specific guidance.

Since no express grant of reg authority to IRS under §951, look to rules of statutory construction to interpret ambiguous statute.

IRS lacked authority to draft regs under Reg. §1.951A-2(c)(5)

fyi – lots of dollars and litigation: Status and Links for the Ongoing Litigation on Meaning of Limited Partner at §1402(a)(13) for SE Tax Purposes

Case	Soroban Capital Partners LP	Sirius Solutions, LLP	Denham Capital Management LP
Tax Court held for IRS applying the "functional analysis test" from Renkemeyer, 136 TC 137 (2011)	TC Memo 2025-52 (5/28/25) – found that LPs "maintained control over the operations of the business, exercising authority over the core functions of Soroban's business" representing 100% of the time of LPs. Held to be "limited partners in name only" and thus subject to SE tax on their share of earnings. Earlier decision at 161 TC 310 (2023) held that court has jurisdiction to determine state law limited partner status for purposes of §1402(a)(13) and that a functional analysis inquire is appropriate. This case also focused on the TEFRA issue on whether SE tax is a partnership item. Court found it was.	Tax Court Order of 2/20/24 – Sirius requested decision in favor of IRS so it could file appeal in 5th Circuit since Tax Court's decision would be the same as in Soroban Capital.	TC Memo 2024-114 (12/23/24) – found that LPs had a "fundamental" role in the operations and investors could withdraw their investments if an LP left. LPs also made more business decisions affecting operations. Per court, LPs were "operating Denham's business as self-employed persons, rather than acting as limited partners as that term would have been understood when Congress enacted section 1402(a)(13)."
Appeals	2nd Circuit – oral argument on 6/25/26 – most of the 30 minutes was spent on the meaning of limited partner under §1402(a)(13); judges seem to lean towards affirming Tax Court. 9/17/26 – 2nd Circuit affirms Tax Court - 3 "principals" subject to SE tax on distributive share of p/s income. They are not limited partners because they exercised managerial control over the firm. Also found that net earnings from self-employment is a p/s item under TEFRA.	5th Cir. (1/16/26) – ""limited partner" in § 1402(a)(13) means a limited partner in a state-law limited partnership that is afforded limited liability. And we reject the IRS's newly adopted passive investor rule." Remand to Tax Court. Dissent found limited partners to be "'limited' in name only" and affirmed Tax Court decision. 5th Cir., (8/12/26) substitute opinion - "limited partner" is a "partner who did not play a significant role in managing or running the business." Dissenting judge still supports Tax Court holding. Case renamed *K Alain, LLLP, et al.*	1st Circuit – oral argument on 2/5/26 – most of the 49 minutes was spent on the jurisdictional issue of whether partner SE tax is a partnership item under TEFRA.
Current Status	2nd Circuit affirmed Tax Court; principles subject to self-employment tax on distributive share of p/s income.	Waiting for decision from Tax Court on remand from revised decision of 5th Circuit	Waiting for decision from 1st Circuit.

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Federal Tax Regulations and IRS Official Rulings

1) List of all Treasury tax regs issued in 2026
2) List of all revenue rulings, revenue procedures and notices published in IRB in 2026 + list of FAQ Fact Sheets issued in 2026

- Also have links with similar info back to 2011.

https://www.sjsu.edu/people/annette.nellen/website/2026regs.html

NATIONAL ARCHIVES FEDERAL REGISTER The Daily Journal of the United States Government

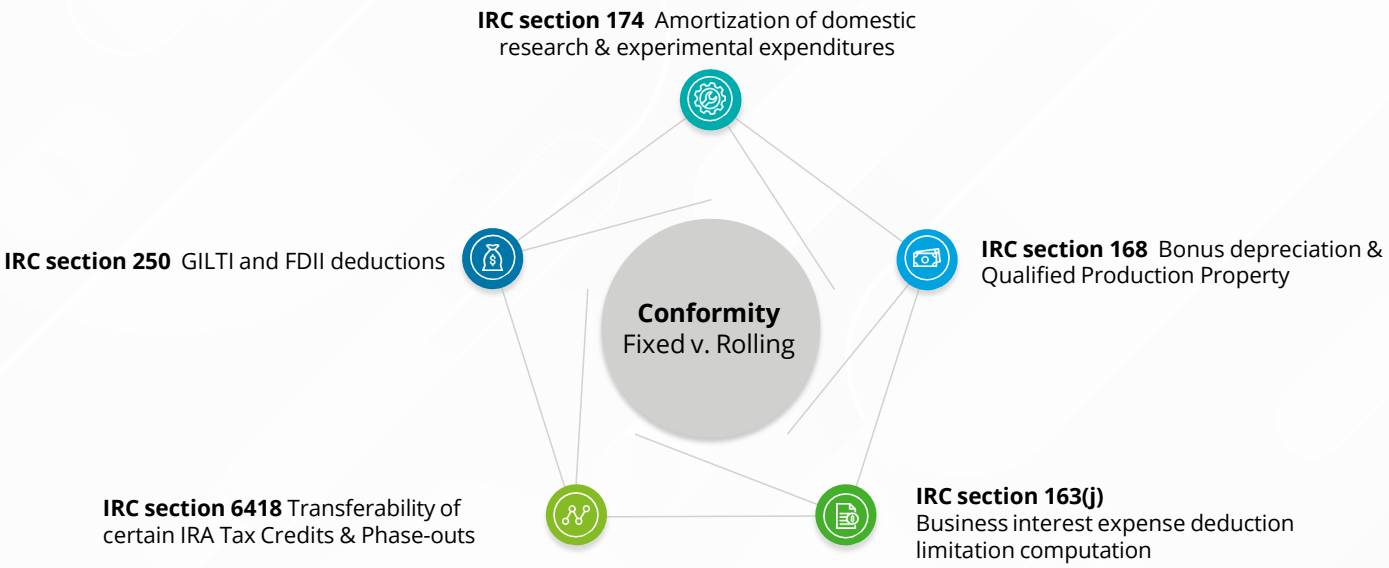
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INTERNAL REVENUE BULLETIN IRS

Multistate Considerations - OBBBA

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Multistate Considerations



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State Treatment of **Domestic** Research or Experimental Expenditures under IRC §174A
As of September 30, 2026

State follows OBBBA treatment of domestic expenditures

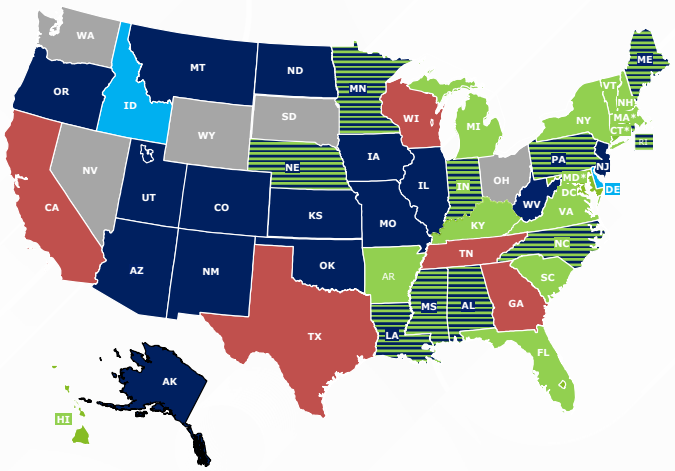
State follows OBBBA for prospective domestic expenditures but provides no or limited deduction for unamortized domestic research or experimental expenditures

State follows TCJA treatment of domestic expenditures

State provides an election or modification

State follows pre-TCJA treatment of domestic expenditures

* For tax year 2025, the state follows the TCJA treatment of domestic expenditures. For tax years beginning on or after January 1, 2026, the state follows the OBBBA for prospective domestic expenditures but decouples from the election to deduct unamortized domestic research or experimental expenditures



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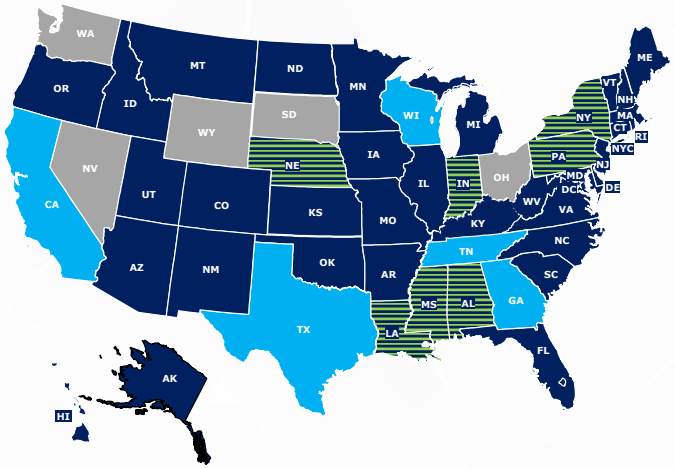
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State Treatment of **Foreign** Research or Experimental Expenditures under IRC § 174
As of September 30, 2026

State follows OBBBA and TCJA treatment of foreign expenditures

State follows pre-TCJA treatment of foreign expenditures

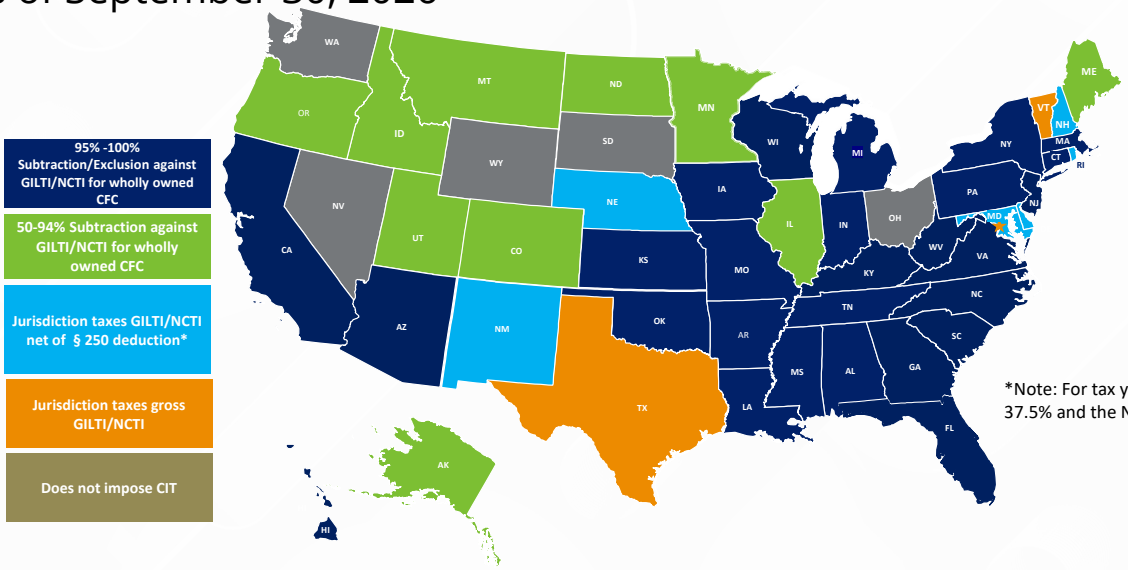
State provides an election or modification



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State Taxation of Global Intangible Low-Taxed Income (GILTI) / Net Controlled-Foreign-Corporation Tested Income (NCTI) - Rules Applicable to Tax Year 2026
As of September 30, 2026



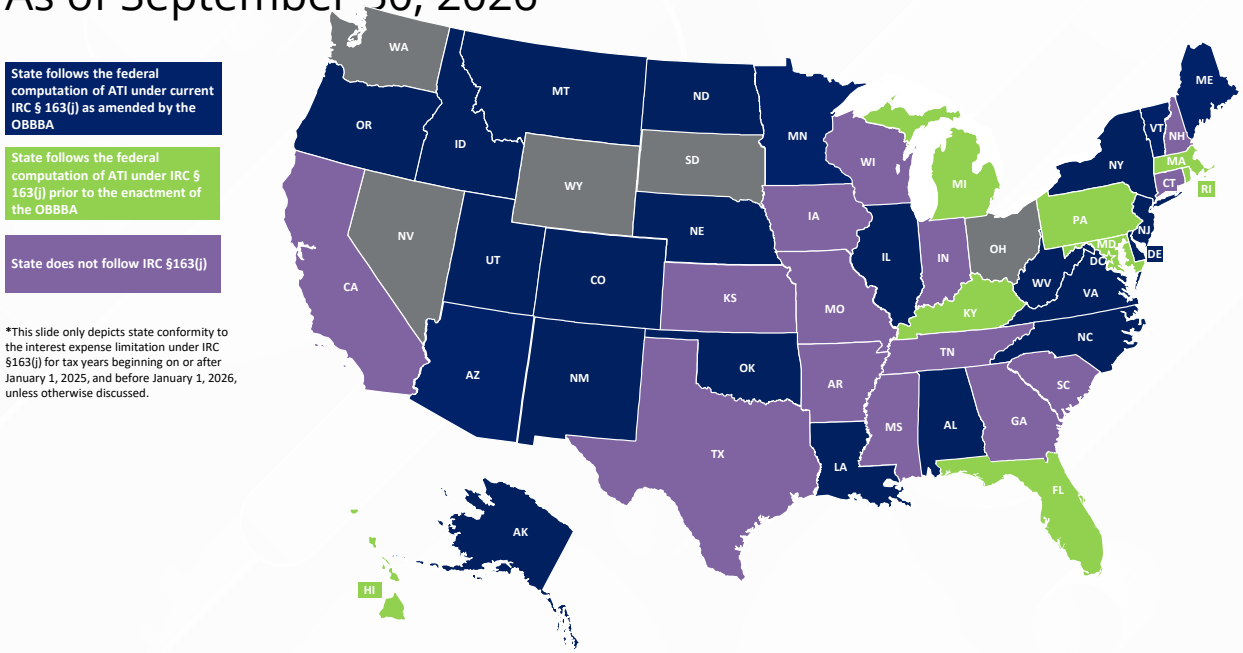
*Note: For tax year 2026 the GILTI deduction is 37.5% and the NCTI deduction is 40%.

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State Conformity to the Interest Expense Limitation under Section 163(j)
As of September 30, 2026



*This slide only depicts state conformity to the interest expense limitation under IRC §163(j) for tax years beginning on or after January 1, 2025, and before January 1, 2026, unless otherwise discussed.

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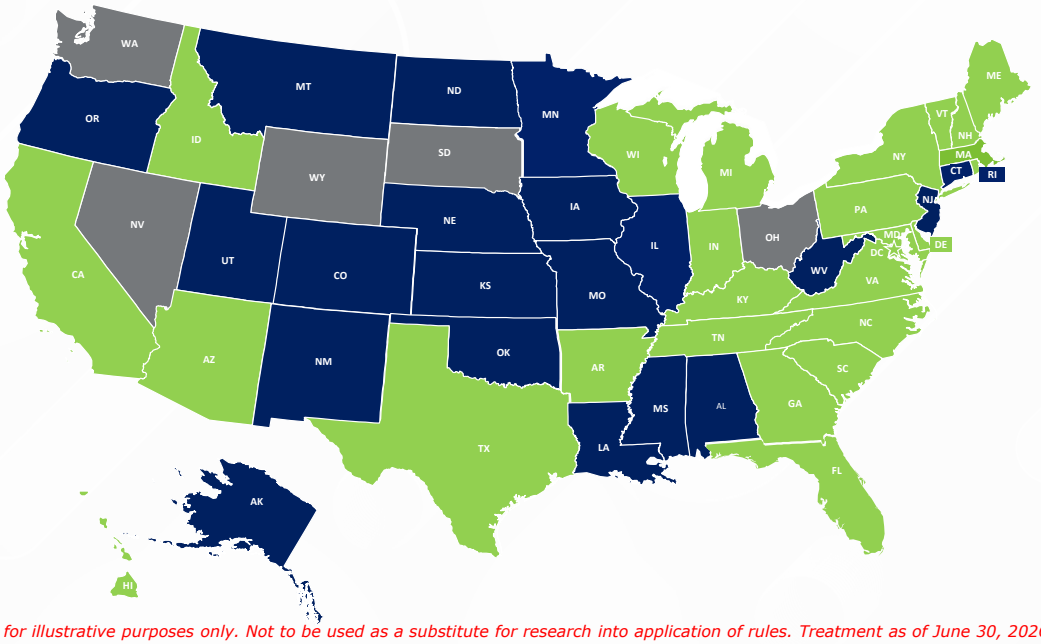
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State Conformity to Expensing of Qualified Production Property under IRC § 168(n)

State allows 100% expensing for qualified production property under current IRC § 168(n) as added by the OBBBA

State does not adopt IRC § 168(n) as added by the OBBBA

*This slide only depicts state conformity to the expensing of qualified production property under IRC § 168(n) for tax years beginning on or after January 1, 2025, and before January 1, 2026, unless otherwise discussed.



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Multistate – CA Law Changes

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California S.B. 122 & A. B. 2222

Credits, NOLs, and More

- S.B. 122 - Continued Limitation on Credit Utilization:
  - S.B. 122 continues to place limitations on the utilization of certain California credits, such as the California research and development credit, jobs tax credit, “California Competes” credit, and motion picture production credit.
    - This temporary limitation and credit refundability continue through taxable years beginning before January 1, 2030.
    - A permanent credit limitation beginning in the 2030 tax year.
    - This permanent limitation generally allows credit utilization up to the greater of $5 million or 70% of the taxpayer’s California tax liability.

- S.B. 122 - Net Operating Loss (“NOL”) Carryover Deduction
  - California suspended the NOL carryover deduction for most taxpayers for taxable years beginning on or after January 1, 2024, and before January 1, 2027.
  - Beginning with taxable year January 1, 2027, taxpayer are permitted to resume the NOL carryover deduction.

- A.B. 2222
  - Updates California conformity to 162m.

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Multistate – Other State Law Changes

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Worldwide Combined Filing

- **Worldwide v. Water's Edge combined unitary filing.**
  - WW includes all unitary affiliates wherever organized.
  - WE limits inclusion primarily to US entities and certain foreign affiliates that meet specified inclusion tests or are brought in by election rules.
- **States with WE/WW elections (CA, CT, DC, ID, MA, ME, MT, ND, NM, UT, WV)**
- **Recent Proposed Legislative Changes/Proposals**
  - California – Proposed Mandatory WW filing
  - Minnesota – Proposed WW filing in 2023
- **Recent Colorado Legislation (H.B. 26-1289, signed June 3, 2026)**
  - Worldwide reporting required for tax years beginning on or after January 1, 2027
  - Water's Edge election allowed on timely filed return, binding for current tax year and subsequent nine years.
  - Unitary Affiliates included in Colorado WE Return:
    - Entities incorporated in the United States (Change to prior 80/20 Rule)
    - Entities where at least twenty percent of property and payroll is United States sourced.
    - Domestic International Sales Corporations, and
    - Entities formed in a listed jurisdictions for the purpose of tax avoidance.
    - Additionally, CO's change in unitary rules applicable to tax years starting January 1, 2026 (3 of 6 tests of unity no longer applicable)

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Texas Franchise Tax – IRC Conformity Update

IRC conformity beginning with Report Year 2026 filing (due 5/15/2026)

- Required to use current-year federal law for federal-return amounts; use 2007 IRC only where Texas statute explicitly cites the IRC.

Rule § 3.587 adopted (2/20/26)

- Total revenue uses federal line items as reported.

Foreign items clarified

- IRC §78 / IRC §§ 951–964 remain 2007 IRC;
- GILTI/FDII and NCTI/FDDEI are not included in subtraction/deduction mechanics.

COGS relief

- One-time net depreciation adjustment available on Report Year 2026 return, though potentially may be able to carryforward benefit if results in negative margin (new rule pending)

Apportionment

- Gross receipts factor follows current-law federal amounts, except where IRC is referenced (new rule pending)

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Other Updates

- Florida (Issued Guidance on OBBBA Decoupling including Pro Forma Requirement)
- New Jersey (New Law Caps CBT NOL Deduction at $1 Million until July 31, 2030)
- Pennsylvania Issued Corporation Tax Bulletin 2026-01 detailing Pennsylvania's current treatment of interest expenses under section 163(j) for tax years beginning on or after January 1, 2025.

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SALT – INDIRECT TAXES

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SALT: Indirect Taxes

2026 Developments

- Transaction taxability: Maryland technology services and New York SaaS licensing.
- Transaction taxability: California, Colorado, Utah and Washington digital/service tax changes.
- Sourcing and marketplace issues: Wisconsin ticket marketplaces and Maryland multiple-points-of-use certificates.
- Digital and data taxes: Illinois, Kentucky, Utah and Maryland developments.

Taxability of Transactions: Maryland

- Technology services regulations effective March 2, 2026 clarify MPU certificates, bundled services and leases. (COMAR 03.12.01.01; Md. Comptroller Tech. Bull. Nos. 54, 56, 59).
- MPU authorization and contemporaneous records are central to allocating in-state use.
- Digital advertising rules focus on programmatic, visually conveyed advertising; revisit scope and refunds.

Taxability of Transactions: New York

- Appellate Division affirmed tax on access to a vendor-management SaaS platform. (*In re Beeline.com, Inc.*, No. CV-24-1494 (N.Y. App. Div. Jan. 15, 2026)).
- Contractual software-license rights and the centrality of platform access drove result.
- Review mixed software/service offerings and contract language.

Taxability of Transactions: California

- SB 122 extends sales and use tax to electronically delivered and remotely accessed digital products beginning January 1, 2027. (Cal. S.B. 122).
- Prewritten software and SaaS are included; custom software remains exempt.
- CDTFA draft rules address digital infrastructure, multiple points of use and direct-payment permits. (CDTFA draft Regs. 1502, 1502.2, 1507, 1600–1600.3, 1699.6).

Taxability of Transactions: Colorado

- HB26-1223 extends sales and use tax to downloaded apps and remotely accessed software from January 1, 2027. (Colo. H.B. 26-1223).
- Custom software and software subject to negotiable license agreements retain exemptions.
- Reassess product classifications and exemption support before implementation.

Taxability of Transactions: Colorado

- Taxability no longer turns principally on software delivery method. (Colo. H.B. 26-1223).
- Identify downloadable, hosted and remote-access products in the product catalog.
- Document custom-software and negotiable-license exemptions; align billing and tax engines.

Taxability of Transactions: Utah

- SB 162 expressly taxes streaming/subscription access to specified digital content from July 1, 2026. (Utah S.B. 162).
- Seller-hosted prewritten software is included in the clarified tax base.
- Coordination rule avoids overlap with the Multichannel Video or Audio Service Tax.

Taxability of Transactions: Washington

- ESSB 5814 expanded retail sales and B&O taxation to multiple service categories. (Wash. ESSB 5814).
- ESSB 6346 prospectively repeals many expanded provisions on January 1, 2029. (Wash. ESSB 6346).
- Advertising services remain taxable; current-law compliance continues until repeal. (Wash. DOR, ESSB 5814 Penalty Relief Program).

Sourcing: Wisconsin

- Wisconsin appellate court treated an online ticket platform as a seller liable for admissions sales tax. (*StubHub Inc. v. Wis. Dep't Rev.*, No. 2024AP455 (Wis. Ct. App. Jan. 13, 2026)).
- The court also upheld a negligence penalty, relying on prior published tax guidance. (Wis. Tax Bull. 172 (2011)).
- Marketplace contract, payment and fulfillment roles may create historical exposure.

Sourcing: Maryland

- SB 644 establishes a new statutory MPU certificate framework effective January 1, 2027. (Md. S.B. 644).
- Two-year authorizations and vendor-level certificates streamline recurring digital purchases.
- Update sourcing evidence, purchasing processes and vendor certificate controls. (Md. Comptroller Tech. Bull. No. 56).

Digital and Data Taxes: Illinois

- SB 3019 creates a 10% targeted-advertising receipts tax and social media platform fee, generally from 2027. (Ill. S.B. 3019).
- Digital Asset Tax Act imposes a 0.2% tax on specified digital asset business activity. (Digital Asset Tax Act, Ill. S.B. 3019).
- Litigation delayed digital asset tax implementation to July 1, 2027; merits unresolved. (*Chamber of Digital Commerce v. Harris*; *Blockchain Ass'n v. Harris* (Ill. Cir. Ct. 2026)).

Digital and Data Taxes: Kentucky

- HB 757 makes data brokering a taxable enumerated service effective August 1, 2026. (Ky. H.B. 757).
- Scope includes collecting, aggregating and analyzing personal data for sale.
- Economic nexus no longer uses the 200-transaction threshold.

Digital and Data Taxes: Utah

- SB 287 creates a 4.7% annual targeted advertising tax beginning January 1, 2027. (Utah S.B. 287).
- Applies to qualifying entities meeting statutory revenue thresholds.
- Impressions-based apportionment makes audience-location data a key compliance input.

Digital and Data Taxes: Maryland

- Maryland Tax Court held the digital advertising tax invalid in three 2022 refund cases. (*Apple Inc. v. Comptroller*, No. 23-DA-OO-0456; *Google LLC v. Comptroller*, No. 23-DA-OO-0649; *Peacock TV, LLC v. Comptroller*, No. 23-DA-OO-0654 (Md. Tax Ct. Aug. 14, 2026)).
- Grounds included ITFA, dormant Commerce Clause and due process; one decision also found a First Amendment violation. (Internet Tax Freedom Act).
- Comptroller sought judicial review; consider refund deadlines without assuming broad non-enforcement.

