NATIONAL **C**ONFERENCE OF **CPA P**RACTITIONERS
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My name is Sanford Zinman. I am a Certified Public Accountant, member of the American Institute of CPA's and am currently the National Tax Chair of the National Conference of CPA Practitioners, (NCCPAP), as well as the President of the Westchester / Rockland New York Chapter. NCCPAP is a professional organization that advocates on issues that affect Certified Public Accountants in public practice and their small business and individual clients located throughout the United States. NCCPAP members serve more than 500,000 businesses and individual clients and are in continual communication with regulatory bodies to keep them apprised of the needs of the local CPA practitioner.

Accompanying me is Mr. Edward Caine, Vice President of NCCPAP who is a CPA in the Philadelphia PA area with a practice similar to mine with clients throughout the United States and overseas.

I am the sole owner of a CPA firm in White Plains, New York which I started almost 30 years ago. I have been preparing individual and small business tax returns as well as sales tax and payroll tax returns for over 35 years. I regularly prepare several hundred income tax returns during any given year and am in the trenches with my clients discussing tax law changes, tax interpretation and projections for planning and estate tax purposes. Although my clients are mostly in the New York, New Jersey and Connecticut area I have many clients in Florida, Alabama, California, Massachusetts, Nebraska, Tennessee and Washington DC. In this respect my practice is the same as many members of NCCPAP and other CPA firms throughout the United States.
The issues regarding the impact of Federal tax provisions which provide benefits and detriments to the states are broad and wide ranging.

From a practical standpoint, or from the standpoint of a CPA professional who is dealing with taxpayer issues daily, there is a need to address the varied types of taxes and how they impact the taxpayer and the tax collector.

The types of taxes which impact taxpayers the most are: Income taxes of individuals and other entities, the related financial planning and estate planning issues faced by these individuals and other entities, employment taxes and State and local sales and use taxes.

Income Taxes of Individuals and Other Entities:

Multi State Residency Issues:

The issue of income tax for individuals with multi-state residency, especially for those who are retired, has grown in recent years. As the pre-baby boom generation is being joined with the beginning of the baby boomers, many of these individuals, married or single, are purchasing second (and in some cases, third) residences in other states and dividing their time between their residences. This poses a problem for these taxpayers–in which state do they declare residency? Currently this issue is not being decided by the individual, but by state tax laws. The state governments have become aggressive in seeking additional sources of revenue. This is not a recent event, but has been going on for many years. For example, the State of New York took a unique position on residency 20 years ago. If an individual sold their home and moved to a different state, cutting all ties with New York State, with one exception - their burial plot located in New York State, New York claimed that, because the plan was to return to the State, the individual would be required to file New York State Resident Income Tax Returns. When word of this came out, there was such uproar that the State of New York quickly reversed this position. Today, determination of residency is somewhat different. However, factors that will be considered in determining residency include, but are not limited to: the number of days spent in each state, where their prized possessions are located, where they are registered to vote, where their car is registered, where their primary care physicians are, and the size of their various residences. Many states are aggressively asserting that individuals are residents to collect resident income tax, use tax and the all important estate tax. I have used New York and Florida as an obvious example but these multi-state issues are prevalent in many jurisdictions. There are Ohio-Florida, Colorado-Nevada transplants and many others.

Another factor that presents a problem for the aging segment of the population is that when taxpayers purchase a second residence in another state, often only one spouse will take the necessary steps for establishing residency in that state such as registering a second vehicle, and registering to vote in that state. This is often done to minimize real property taxes. The State of Florida has limits as to how much real property taxes can increase on a primary residence for Florida homesteaders. If however, that residence is not the primary residence, then the real property taxes can increase by greater amounts from year to year. This can lead to a problem with a surviving spouse who then passes.

As example: a couple from New York purchases a second residence in Florida. Spouse #1 declares Florida residency, gets a Florida driver's license, registers to vote in Florida, etc., while Spouse #2 remains a New York resident. Spouse #1 dies and Spouse #2 spends most of the next 20 years living in Florida, but never makes the changes with regard to their own residency. When Spouse #2 passes away, the estate of Spouse #2 has to file an estate tax return in New York. This is necessary even though, while alive for the past 20 years, Spouse #2 was not required to file in New York because the taxpayer was not living in New York. But for the technicality that the individual did not bother to make the necessary change to establish residency in Florida the executor now has to file an estate tax return in a state in which the individual did not live.

A taxpayer faces many tax complexities when relocating from state to state. For example, a couple just relocated from New Jersey to California in October of 2011. Their income includes self-employment income, interest, dividends, capital gain transactions, and rental property, and they have the usual gambit of itemized deductions. In order to properly prepare their state returns, all of the income and expense items need to be allocated between the two states. So the federal government includes 100% of all the items and the states require that each item on the return be allocated appropriately to the respective states. So, three Schedule C's reporting self-employment income were prepared, one for the federal, one for NJ and one for CA. Three Schedule B's reporting interest and dividend income were prepared, etc.

Tax Treaties:

The United States government has income tax treaties with many countries. However, many of the states do not recognize these treaties, so a non resident alien may not be required to pay federal taxes under a treaty but the individual may be required to pay state taxes. Example: A New Jersey partnership with two partners from Israel sold its technology rights to an Israeli Corporation. The Israeli corporation pays royalties to the New Jersey partnership based on sales of the developed product. In accordance with the US/Israeli treaty, the Israeli partners pay U.S. federal tax on the royalty generated from the sale of product to U.S. customers only.   As the State of New Jersey does not honor the tax treaty, the State imposes a tax, in this case, on 100% of the royalty paid worldwide.

Business Jurisdiction Issues:

I acknowledge that federal law should not usurp state law, but individuals are left to battle with each jurisdiction that wants a piece of the action and their tax dollars. This also happens with other entities. Businesses which have nexus in multiple jurisdictions are also potentially subject to double or triple taxation. Although all states will acknowledge that credits should be given for taxes paid to other jurisdictions, those credits will not be given if the state perceives that the tax paid to another jurisdiction is improper. This again leaves the taxpayer in the uncomfortable position of either risking a wrong move or overpaying taxes to avoid lengthy administrative hearings.

Alternative Minimum Tax:

And then there is dreaded Alternative Minimum Tax ("AMT"). The National Conference of CPA Practitioners has long advocated for the abolishment of the alternative minimum tax. More than being a regressive tax and a hardship on a portion of the taxpaying public that was not the original target of this tax; the AMT disproportionately affects taxpayers in certain states and areas of the country. While it is clear that this was an unintended consequence of the law, Congress has been unable to address the elimination of this tax.

The tax practices of many of our members are, like my practice, comprised of couples who are earning very good salaries so they can afford to live in communities with high income and real estate taxes. As little as ten years ago, none of these individuals had to think about the AMT when they considered where to live and purchased their homes. Now, it is a regular discussion that is happening within many tax practitioners' offices. Many of these taxpayers are located in the New York metropolitan area because that is where they were able to find work. And, no, they are not all wealthy money managers or hedge fund traders. These taxpayers are often regular, middle-class working people; teachers, police officers, civil servants, executives and business owners. But the wages they must earn and the state and local taxes they must pay makes them subject to a 25 to 28% federal tax bracket. These same people would be paying a 15 to 20% federal tax rate if they lived in a lower taxed state and they would be living the same life style. But there is no consideration of regional or local cost of living standards within the AMT rules. So these middle class, two worker families trying to save for college for their kids are being hammered on their federal taxes. This problem only compounds itself because these taxpayers have to earn more to offset the extra federal tax burden. This is an area where federal policy could assist the states. In theory, if federal taxes were lowered for these taxpayers, their disposable net income would be increased and there might be fewer objections to state and local income and property taxes.

<u>Financial Planning issues for Individuals, Estates and Businesses:</u>

Having just discussed the problems faced by individuals related to the AMT, I would like to discuss how this and other tax issues affect the individual and business taxpayers. I will start with a background story.

One of my clients is an estate and elder law attorney who earns a good living, works in one state and lives in another. Last year, just after I had completed his 2010 tax return, he asked me to help him plan for 2011. He wanted to know what I thought was going to happen with tax rates, AMT and specific items such as bonus depreciation and Internal Revenue Code section 179. My response was in the form of a question. I asked him what the estate tax exemption was going to be in 2012 and 2013 and if there would still be a tie in with the gift taxes. We agreed that we knew very little about the near future changes of tax law. How can someone plan to pay the correct amount of tax to the federal government (and even the state) in April or June or even September when, all too often, no one knows what will happen until December. This uncertainty is a recipe for disaster.

Similarly there are many practical issues that tax preparers face when preparing income tax returns that are the result of legislation enacted in November or December. An example of this is Form 8949 – Sales and Other Dispositions of Capital Assets.

This issue arose very late in the year and has caused concern and, at times, an extra burden within the tax preparer community and amongst the taxpayers themselves.

Many financial advisors have written to their clients advising them that the return preparer should note that the cost basis of their stock sales was incorrectly calculated regardless of whether this is or is not true. That is easy for the financial advisors to write because they are not signing the returns as true and correct. However, this is also a correct statement since the advisors were often unable to receive the transaction information within a reasonable time frame to determine if all the trades were properly recorded. This has placed additional burden on the taxpayers and tax preparers and will impact the Internal Revenue Service when these returns are audited. The brokerage houses must generate and provide corrected 1099 forms to taxpayers (sometimes after the filing deadline). Taxpayers must then file amended income tax returns. Until the modernized efile system is completely operational, the taxpayer must file the federal and respective state returns on paper and the Internal Revenue Service and State service centers must process the amended tax return manually. This causes an additional burden on all.

Employment Taxes:

Workforce mobility is here to stay. Workers travel to different states either to find new work or better pay or because they are temporarily reassigned to a different location by their employers. Federal law recognizes this mobility and offers individuals and entities incentives to insure that workers can keep working and companies can keep good workers. However, state and local employment laws and regulations vary greatly from state to state. In addition, there is no uniform definition of which types of workers are employees and which are independent contractors. Even within states, there are different definitions of who is an employee for withholding tax, unemployment insurance, worker's compensation insurance and other employment related taxes. Connecticut employers who are also Massachusetts employers must be very careful about the employment laws within each state in determining if a recipient of money is an employee or an independent contractor. In most, if not all states, federal guidelines do not control the state determination of employment status. Equally important, employee wage reporting requirements vary widely from state to state causing difficulty for small employers who are preparing employee W-2 forms. Individual employee issues are addressed separately. As indicated, the federal government should not be attempting to usurp state rights or jurisdictional standing, but, to help promote more business activities; the federal government must assume a more active role in the administration of employment taxes and encourage a uniform definition of who is an employee. The Treasury department regulations on the uniform definition of a qualifying dependent have gone a long way to resolving the related income tax issues. A similar effort on who is an employee would be extremely helpful and would do a lot to level the playing field for employers.

Sales and Use Taxes:

Sales and use tax issues significantly affect state and local governments. Over the past several years, in an effort to increase revenues, states have increased their collection efforts. By the end of 2011 eight states have enacted click-through nexus provisions and more than fifteen states have proposed laws expanding sales tax nexus. Based on the Supreme Court decision in the Quill case there has been the requirement of a physical presence in the state before that state could assert nexus. The states have begun to look for any connection that an out-of-state seller might have that could be construed as a physical presence and some states have enacted legislation imposing a sales tax liability on internet companies if the company has agents in the state. With the explosion of internet sales states are now looking at ways to expand the range of activities which creates nexus. One can look at the recent Overstock.com and Amazon.com cases to see the trend of state regulations and the pursuit of lost sales and use tax revenue. Additionally, many states are now requiring individuals to report use tax on taxable items purchased out of state on their state income tax returns in an effort to reclaim some of the lost revenue.

While most people understand the need for separation of federal and state governments, it is apparent that there is a loss of sales tax revenue due to cross border sales. It should also be obvious that this represents a loss of revenue to brick and mortar small business retailers who have a physical presence in a state but are not big enough to be a multi state retailer. In areas where state borders are nearby, companies may choose to establish their offices in one state just so they can sell in another and may deliberately run their business in a specific way to avoid the sales tax collection issues. Often businesses look to establish themselves in sales tax friendly states with the ability to sell to neighboring jurisdictions and to avoid collecting and paying sales tax to the destination state. I have had experiences with business owners who specifically try to establish their businesses in states neighboring New York to avoid the higher rate of sales tax and the complexity of the sales tax forms. I was also privy a case where a jeweler, with offices in Manhattan, sold and shipped items to customer's homes in other states to avoid the collection and remittance of sales tax on big ticket items.

The Multistate Tax Commission, in 2011, directed its sales and use tax uniformity subcommittee to begin drafting a model nexus statute based on the Amazon case. There is a strong need for federal oversight of state sales and use tax to insure that all states are able to collect their proper tax revenue.

Respectfully submitted,

Sanford Zinman, CPA

On behalf of the National Conference of CPA Practitioners.