The State Tax Pentathlon

by Annette Nellen

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Annette Nellen is a professor at San Jose State University and director of the graduate tax program. She is the past chair of the American Institute of CPAs Tax Executive Committee and an active member of the taxation sections of the AICPA, American Bar Association, and California Lawyers Association.

In this installment of Moving Forward?, Nellen continues with the theme of a September 2016 Tax Notes State article in which she suggested suitable events for a state tax decathlon in the spirit of the 2016 Olympic Games in Rio de Janeiro. The 10 challenging tax tasks suggested five years ago still work in 2021. Now, in honor of the Summer Olympics in Tokyo, five appropriately challenging state tax tasks are suggested for the state tax pentathlon.

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I. Demanding Olympic Events

A. Why a Grueling, Multipart Event Makes Sense

Both the decathlon and pentathlon are grueling events requiring significant training, strength, skill, endurance, discipline, judgment, patience, acuity, and financial resources.¹ These multisport events can readily be analogized to the wide range of knowledge, acumen, skills, practice, dedication, and fortitude needed by competent multistate tax practitioners. State and multistate practitioners are like the Olympians who prepare for the multi-event competitions. These practitioners must have skills and knowledge of federal tax law; the tax laws of 50 states and the District of Columbia; U.S. and state constitutional law; tax compliance; tax policy; tax technology; and tax research, accounting, and finance.

B. Review of the 2016 State Tax Decathlon

Before getting to suggestions for the state tax pentathlon, let’s review earlier suggestions for the two-day, 10-event state tax decathlon.² Like the Olympics event — when designed as a contest for tough, experienced state tax practitioners — it requires years of training, practice, fortitude, and wisdom. Even five years later, the state tax decathlon remains a challenge, particularly considering the participants must have the skills, knowledge, and strength for each of the 10 demanding subevents.

1. The “Jock Tax” Challenge — Competitors must calculate the state tax obligations for a professional athlete (such as an NFL player) and employees who travel with the team from state to state. Five random states with an income tax are assigned at the start of the competition.

2. Multistate File and Plan — Information is provided for an individual with activities in at least 10 states and wage or self-employment income in multiple states. The individual has children, investment income, and partnership income. Returns


for at least two states must be prepared, and estimated taxes must be calculated for the subsequent year. E-filing must be performed. Also, contestants must explain how the individual can change her state tax domicile, and based on the facts, which state she should move to and why.

3. The Business Split — Challengers calculate state income tax obligations of a multistate, multifaceted business under varying systems, such as the Uniform Division of Income for Tax Purposes Act, market sourcing, single-sales apportionment, throwback, and Joyce and Finnegan. Varied fact patterns for determining unitary operations are involved.

4. Nexus Confidence — Competitors are given three fact patterns and asked to determine where the business has income and sales tax nexus. Fact patterns vary in terms of type of entity, location of owners and customers, and nature of the products or services offered (including digital items). Competitors must determine when nexus begins and ends.

Update: The Wayfair decision\(^3\) makes this event simpler when a business has clearly passed an objective nexus threshold based on sales or number of transactions, although these definitions and thresholds can vary from state to state. But challenges still exist when P.L. 86-272 applies or when the economic nexus thresholds are not met but minimal physical activity may exist.

5. Amicus Drafting — Contestants must research and write an amicus brief to convince a court to hear a case. The brief must cite at least 30 cases and be in proper format. The topic is selected from issues before any federal or state court and judged on clarity and whether the judges are convinced to take the case.

6. Power of the People — Competitors draft the ballot materials for a state tax initiative. It must be understandable to a layperson and supported by appropriate data and legal explanations. If needed, the tiebreaker event is to write the opposing view for the initiative and be just as convincing.

7. Harmony — Contenders draft federal legislation acceptable to e-commerce vendors, main street retailers, consumers, and state governments that improves sales and use tax compliance.

Update: Considering Wayfair\(^4\) and state changes, this event must be updated for 2021. A suitable replacement is to draft a bill for congressional consideration on nexus and marketplace facilitator uniform laws and pro and con arguments for uniformity.

8. Dust It Off — Competitors convince a state legislature to hold a hearing and act on a report prepared by a state commission or committee charged with examining the state tax system for reform or analyzing tax expenditures. A list of reports that were either ignored or inadequately examined is given to the competitors. Judges include legislators who score based on their likelihood of holding a hearing based on the arguments made.

9. Base Broadening — Participants identify a state tax incentive used by at least 10 percent of businesses and make a convincing argument why it should be repealed. The argument must consider both compliance and economics. An alternative event involves making convincing arguments why a state’s sales tax base should be broadened to include food, utilities, services, and digital items.

10. Tax Literacy — Competitors design an education plan for high school students to understand their state’s tax system, compliance obligations of employees, and self-employed entrepreneurs (such as freelancers), and how businesses determine their tax obligations in the state. Competitors must explain how to analyze the “health” of the tax system and how to analyze tax legislative proposals and ballot initiatives. Participants must be sure

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\(^4\) Id.
students learn how and where to get reliable state tax information.

II. The State Tax Pentathlon

A. Major Changes Over the Last 2,700 Years

Unlike skateboarding and surfing, which debut at the Tokyo Olympics as new events, the pentathlon dates to the start of the Olympics in the eighth century B.C. Also, unlike these new events, the design of the pentathlon likely represented skills of a warrior or soldier.

Scholars differ over the sequence of events in ancient times, although wrestling as the final event for those not eliminated in the preceding four events is consistently reported. The events of the pre-modern pentathlon were the long jump, spear throw (javelin), run, discus throw, and wrestling.

The pentathlon was updated at the end of the 19th century to be a test of the “ideal, complete athlete.” The events were intended to test skills needed by a soldier delivering a message on horseback who must go on to deliver the message even when the horse cannot continue. The soldier must then rely on his sword, pistol, and swimming and running abilities to complete the delivery. This modern competition debuted at the 1912 Games in Stockholm. Women were first allowed to compete in a pentathlon at the 2000 Games in Sydney. At the 1996 Summer Olympics in Atlanta, the event was condensed from a four- or five-day contest to a one-day competition. Starting with the London Games in 2012, running and shooting were combined into one event with laser pistols being used.

Today’s pentathlon proceeds as follows: (1) fencing competition (a minimum of 35 bouts), (2) 200-meter freestyle swim, (3) equestrian event involving 12 obstacle jumps of up to 4 feet in height on a horse assigned to the competitor, and (4 and 5) the combined finale with a total run of 3,200 meters with four stops to shoot at five electronic targets at each stop.

B. The Tax Events

Clearly, the pentathlon requires an amazing skill set that few people have or would even consider pursuing — fencing, swimming, horse riding and jumping, pistol shooting, and running is not a typical weekend workout. But the work of the state tax professional is also quite challenging and varied and not one all tax professionals consider pursuing. Just the need to have a strong knowledge base in both federal and state tax laws, procedures, and policies is an amazing feat.

So what is suitable for the state tax pentathlon? I suggest the following:

(1) Practitioner-Auditor Examination Faceoff — Similar to the fencing round, competitors have 35 bouts in which issues are raised on a range of fact patterns with the contestant judged on the swiftness, accuracy, and persuasiveness of each verbal response.

(2) Build Back Better State Response — This event is renamed for each Olympiad for the relevant federal tax reform that is under consideration at the time of the Olympics. For 2021, it is certainly President Biden’s Build Back Better program, which features numerous tax changes that include family tax credits, a corporate rate increase, changes to international provisions, new and reformed energy credits, repeal of fossil fuel preferences, and new information reporting requirements. In this event, competitors provide recommendations to state lawmakers on what they think should be included in the federal reform, what improvements can be made to provide a better tax...


7. Zarnowski, supra note 6, at 11, orders the events as discus throw, jump, javelin, sprint, and wrestling. Hagerman, supra note 6, orders the events as long jump, spear throw, sprint, discus throw, and wrestling.


9. Id.

10. Id.


system that will benefit states, and what proposals might be harmful to the states.

(3) Speed Answering — Like the horse riding and jumping event where athletes do not know the horse they will be assigned, contestants must answer questions from the taxpayer and practitioner phone lines of any 12 randomly selected state tax agencies. Points are awarded for accuracy, clarity, and politeness.

(4 and 5) Federal and State Tax Research — Like the run and pistol shooting event, this contest requires participants to provide answers to address both the federal and state tax treatment of tax issues that might range from calculation of credits to procedural matters. A timely topic for the 2021 games is to find the federal and state (for a specified state) tax treatment of the myriad COVID-19 grants, loan forgiveness plans, vaccine prizes, and more that were provided by federal, state, and local governments, companies, nonprofits, and employers. The added challenge is that some of the tax guidance is provided in the law that created the grant, such as the federal restaurant revitalization fund and shuttered venue operators grants, provided by the American Rescue Plan Act (P.L. 117-2). This is a challenging event because one must check the enacting legislation to see if it addressed the tax treatment of the grant, forgiveness plan, or prizes, and if not, whether existing rules address the income. For this 2021 event, the contestants must address the tax treatment of a business’s expenses paid for with grant or forgiven loan proceeds. Judging considers accuracy, speed, and level of frustration (if any) demonstrated in dealing with complex issues and incomplete guidance.

An example of the challenge of combined event 4 and 5 for just a few of the types of COVID-19 grants an individual may have received, with the federal and California tax treatments provided, is available in the appendix.

III. Looking Ahead

Significant changes in the pentathlon from the ancient Olympics to the modern Olympic Games have not really diminished the grueling physical and mental nature of the competition. Arguably, something similar could be said regarding state tax practice. While some tax issues may have been simplified or resolved over time, new rules and increasingly complex business and investment activities create new challenges, easily described by analogy to the Olympic decathlon and pentathlon events.
Appendix

Example of the Work Required for the 2021 State Tax Pentathlon Event 4 and 5

Task: Provide the federal and state tax treatment of the following individual COVID-19 grants and debt forgiveness, with California randomly selected as the state to research.

<table>
<thead>
<tr>
<th>Type of COVID-19 Assistance</th>
<th>Federal Tax Treatment</th>
<th>California Tax Treatment</th>
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</thead>
<tbody>
<tr>
<td>COBRA premium assistance (American Rescue Plan (ARPA) section 9501) for coverage from employer for April 1, 2021, to September 30, 2021 (employer gets refundable credit per IRC section 6432).</td>
<td>Excluded per IRC section 139I; added by ARPA.</td>
<td>California likely does not conform.</td>
</tr>
<tr>
<td>Funeral assistance from Federal Emergency Management Agency.</td>
<td>Excluded under IRC section 139(b) if received during a federally declared disaster.</td>
<td>California appears to conform to IRC section 139 with slight employment tax modification if paid by employer (DE 231SED, 3/20).</td>
</tr>
<tr>
<td>Employer cash and noncash incentives for COVID-19 voluntary vaccinations.</td>
<td>Taxable compensation under IRC section 61. Does not fall under the section 139 exclusion because not paid for reasonable and necessary personal, family, living or funeral expenses of the employee. Does not appear to fall within any fringe benefit provision, such as IRC section 132.</td>
<td>Same as federal.</td>
</tr>
<tr>
<td>Qualified financial aid grant for student (CARES Act, section 3504, or grant from a university under CARES Act section 18004 or any other emergency financial aid grant from federal, state, Indian tribe, university, or scholarship-granting organization made because of emergency under CARES Act section 3502(a)(4)).</td>
<td>Not taxable; grant not treated as described at IRC section 25A(g)(2)(A), (B) or (C) (Consolidated Appropriations Act 2021 (CAA-21) section 277); effective for grants made after March 3, 2020. Taxable if the award is payment for teaching, research, or other services required to receive the qualified emergency financial aid grant (CAA-21 section 277(c)). Applicable for grants made after March 26, 2020.</td>
<td>FTB 2020 Conformity Report: “California does not conform to the federal exclusion from gross income of emergency financial aid grants, and also does not conform to the federal American Opportunity and Lifetime Learning tax credits.” See California Franchise Tax Board, “Summary of Federal Income Tax Changes” (updated April 14, 2021). Query: Might IRC section 139 apply?</td>
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<td>Rent forgiven by landlord.</td>
<td>If cancellation of debt, see if any IRC section 108 exclusion, such as for insolvency, applies. Does not seem to fall under IRC section 139 because it is not a payment.</td>
<td>For 2020 through 2024, excluded by an addition to Health &amp; Safety Code section 50897.1(j)(2) made by A.B. 81. This new provision states: “(2) Notwithstanding any other law, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, gross income shall not include a tenant’s rent liability that is forgiven by a landlord as provided in this chapter or as rent forgiveness provided through funds grantees received as a direct allocation from the Secretary of the Treasury pursuant to Subtitle A of Title V of Division N of the federal Consolidated Appropriations Act, 2021 (P.L. 116-260).”</td>
</tr>
<tr>
<td>California Golden State Stimulus (GSS) payments of $600 if claimed the California Earned Income Tax Credit in 2020 or had adjusted gross income of $75,000 or less (Welfare and Institutions Code Sec. 8150) created by S.B. 88 (Chapter 8, Feb. 23, 2021). See FTB, “State Issues 2.5 Million Golden State Stimulus Payments,” May 6, 2021. S.B. 88 (Chapter 8, Feb. 23, 2021).</td>
<td>S.B. 88 refers to the GSS payments as a one-time tax refund payment. Thus, they should not be subject to tax. If the payments are not viewed by the IRS as a tax refund, these payments might be excluded under the general welfare exclusion because they are paid under a government program; paid for the promotion of the general welfare as evidenced by this being a needs-based system; and are not paid for services. See IRS Information Letter 2019-0024. IRC section 139 might also support exclusion.</td>
<td>Excluded per Rev. &amp; Tax. Code section 17131.11. See FTB, “Golden State Stimulus” (updated July 13, 2021).</td>
</tr>
</tbody>
</table>

Notes: The chart lists only a few types of federal and state programs providing pandemic-related payments to individuals. There are many more types of programs with payments from governments, private companies, nonprofits, employers, and more, and varied programs offered by state and local governments. Guidance continues to be issued by the IRS, and state tax agencies and legislatures continue to consider more favorable tax treatments.