

State and Local Tax (“SALT”) Presentation

SMITH + HOWARD ADVISORY, LLC
Chattanooga Tax Practitioners Meeting
January 28, 2026
12-1 p.m. EST

Presented by Brandee A. Tilman, Director, SALT



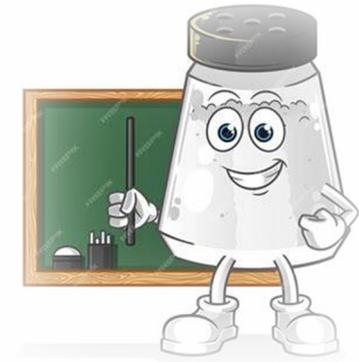
Today's Agenda

SALT Topics

- Introduction
- State Tax Implications of the One Big Beautiful Bill (“OB3”) in AL, GA, NC, SC and TN
- Impact of Increased SALT Deduction on State PTET Elections
- Sales-by-State Data vs. State Revenue Sourcing Requirements: Opportunities to Provide Value and Mitigate Risk
- Revenue Sourcing Analysis Drives Value for Client: A Case Study

My Ask of You

- Please feel free to interject with questions or comments during the presentation.



Learning Objectives

Following this session, participants will be able to:

- Identify the state income tax implications of the One Big Beautiful Bill (“OB3”) on states that are impactful to clients.
- Evaluate whether the state pass-through entity tax (“PTET”) election remains advantageous to clients given the increased SALT deduction under OB3.
- Recognize the importance of client sales-by-state data and how to provide value and mitigate risk by ensuring it is consistent with state revenue sourcing requirements.

Polling Question # 1

What do you expect the impact will be to your client base for the 2025 tax year as a result of the enactment of OB3?

- A. Decrease in income tax liability
- B. Increase in income tax liability
- C. No material change in income tax liability
- D. Too early to tell

State Conformity to Internal Revenue Code

STATE	IRC CONFORMITY METHOD	IRC CONFORMITY DATE	COMMENTS
AL	Rolling	Current IRC	
GA	Fixed Date	IRC as enacted on or before 01-01-2025	
NC	Fixed Date	IRC as enacted as of 01-01-2023	
SC	Fixed Date	IRC as amended through 12-31-2024 unless SC has affirmatively decoupled from a specific provision.	SC also conforms to any IRC provisions that expired as of 12-31-2024 but were subsequently extended after that date without modification.
TN	Rolling	Current IRC	To the extent TN has previously decoupled from or adopted a specific provision of the IRC as of a specific date, OB3 changes impacting such provision will not be automatically adopted.

AL Conformity to Select OB3 Changes

STATE CONFORMITY TO CHANGES ENACTED IN OB3 TO THE FOLLOWING IRC PROVISIONS:

STATE	IRC § 163(j)	IRC § 174A	IRC § 168(n) Elective 100% Depreciation for QPP	IRC § 168(k) Bonus Depreciation	IRC § 179 Expensing
AL	Yes	Yes. However, AL allowed the option of deducting any remaining unamortized R&E expenses from the 2022 to 2024 tax years to be fully deduction for tax years beginning on or after 01-01-2024. To the extent such option was selected for the 2024 tax year, a state modification will be necessary for the 2025 and/or 2026 tax years for R&E expenses previously deducted on the 2024 AL tax return.	Yes	Yes	Yes

GA Conformity to Select OB3 Changes

STATE CONFORMITY TO CHANGES ENACTED IN OB3 TO THE FOLLOWING IRC PROVISIONS:

STATE	IRC § 163(j)	IRC § 174A	IRC § 168(n) Elective 100% Depreciation for QPP	IRC § 168(k) Bonus Depreciation	IRC § 179 Expensing
GA	No. GA previously decoupled from the IRC § 163(j) business interest deduction limitations and instead follows this provision as it existed prior to the enactment of the TCJA.	GA previously decoupled from the R&E changes enacted in the TCJA so it already allows a full deduction of R&E expenses in the tax year in which they were paid or incurred; hence, it will continue to follow such treatment.	No	No. GA specifically decouples from IRC § 168(k).	No

NC Conformity to Select OB3 Changes

STATE CONFORMITY TO CHANGES ENACTED IN OB3 TO THE FOLLOWING IRC PROVISIONS:

STATE	IRC § 163(j)	IRC § 174A	IRC § 168(n) Elective 100% Depreciation for QPP	IRC § 168(k) Bonus Depreciation	IRC § 179 Expensing
NC	No	No. NC continues to conform to IRC § 174 changes enacted in the TCJA, which requires capitalization of R&E expenses over 5 years.	No. NC requires an add back of 85% IRC § 168(n) for property placed in service during the taxable year but can later deduct 20% of the amount added back over a 5-year period.	No. NC requires an add back of 85% IRC § 168(k) for property placed in service during the taxable year but can later deduct 20% of the amount added back over a 5-year period.	No

SC Conformity to Select OB3 Changes

STATE CONFORMITY TO CHANGES ENACTED IN OB3 TO THE FOLLOWING IRC PROVISIONS:

STATE	IRC § 163(j)	IRC § 174A	IRC § 168(n) Elective 100% Depreciation for QPP	IRC § 168(k) Bonus Depreciation	IRC § 179 Expensing
SC	No. SC previously decoupled from the IRC § 163(j) business interest deduction limitations completely and allows eligible taxpayers to deduct 100% of their business interest expense.	No. SC continues to conform to IRC § 174 changes enacted in the TCJA, which requires capitalization of R&E expenses over 5 years.	No	No. SC specifically decouples from IRC § 168(k).	No

TN Conformity to Select OB3 Changes

STATE CONFORMITY TO CHANGES ENACTED IN OB3 TO THE FOLLOWING IRC PROVISIONS:

STATE	IRC § 163(j)	IRC § 174A	IRC § 168(n) Elective 100% Depreciation for QPP	IRC § 168(k) Bonus Depreciation	IRC § 179 Expensing
TN	No. TN previously decoupled from the business interest deduction limitations and instead it follows IRC § 163(j) as it existed prior to enactment TCJA.	TN previously decoupled from the R&E changes enacted in the TCJA so it already allows a full deduction of R&E expenses in the tax year in which they were paid or incurred; hence, it will continue to follow such treatment.	No. However, TN conforms to the TCJA depreciation provisions for assets placed into service after 12-31-2022.	No. However, TN conforms to the TCJA provisions for assets placed into service after 12-31-2022.	Yes

Polling Question # 2

Which of the following states have NOT conformed to any provisions of OB3 for 2025?

- A. AL and TN
- B. GA, NC and SC
- C. AL and GA
- D. GA and TN

OB3 Increases SALT Deduction for Individuals

New SALT Deduction Limitation for 2025 through 2029

- **2025:** SALT deduction increases in 2025 to \$40,000 from \$10,000 (\$20,000 from \$5,000 for MFS).
- **2026:** SALT deduction increases in 2026 to \$40,400 (\$20,200 for MFS)
- **2027-2029:** SALT deduction increases by 1% each year after 2026 through 2029.
- **2030:** SALT deduction reverts to \$10,000 (\$5,000 for MFS).

New SALT Deduction Limitation Income Phase-Out

- SALT deduction is reduced (but not below \$10,000 or \$5,000 for MFS) by 30% of the amount that an individual's modified adjusted gross income exceeds the threshold amount set for each tax year.
- Federal modified adjusted gross income threshold amounts for phase-out:
 - **2025:** \$500,000 (\$250,000 for MFS)
 - **2026:** \$505,000 (\$252,500 for MFS)
 - **2027-2029:** Threshold increases by 1% each year after 2026 through 2029.

State PTET Election Considerations

State PTET Elections May Be Less Valuable to Some Clients

- Higher SALT deduction limitation may decrease the federal tax savings for individuals whose state taxes are below the new threshold.
- Incremental costs and administrative burden to administer the state PTET election may outweigh the benefit to partners given the reduced federal tax savings.
- State PTET elections that provide non-refundable tax credits to individuals or less than 100% tax credits may be more costly to those receiving a lower or no federal tax savings.

State PTET Elections Continue to Provide Value to Other Clients

- High-income taxpayers subject to the phase-down will still recognize significant federal tax savings through a state PTET election.
- State PTET elections decrease federal taxable income, which may reduce self-employment income and corresponding self-employment taxes.
- State PTET elections may help optimize the use of the standard deduction or unlock above-the-line charitable deductions for clients that do not itemize.

SALT Deduction Increase Impacts Many

Impact to Individuals of Increase in SALT Deduction

- Potentially decreases the value of state PTET elections for:
 - Individuals with modified adjusted gross income below the phase-out thresholds.
 - Individuals whose SALT deduction with or without a state PTET election will not exceed the increased \$40,000 SALT deduction cap.

Impact to Tax Service Providers of Increase in SALT Deduction

- Likely requires tax service providers to run comparative calculations each tax year to determine the most beneficial course of action for clients.
- Likely requires upfront real-time planning to determine what option is most favorable for clients due to early SALT PTET election deadlines and withholding requirements for nonresident partners if the qualified entity does not make a state PTET election.

Impact to Qualified Entities of Increase in SALT Deduction

- For state PTET elections that do not have a consent or opt-out provision, management may need to resolve conflicts between partners that want to make a state PTET election vs. those that do not due SALT deduction increase and varying income levels.

Revenue Sourcing: Common Methodologies

Methods of Sourcing Revenue from Sales of Other Than Tangible Personal Property

- Market sourcing focuses on the location in which the taxpayer's customer receives the benefit of the taxpayer's services.
- Cost of performance ("COP") sourcing focuses on the location in which the costs of performance occurs that give rise to the income-producing activity.

States Move to Market-Based Sourcing

- Majority of states have adopted market-based sourcing for sales of other than tangible personal property.
- *As of 12/31/2025:* 35 states plus D.C. and NYC use market-based sourcing for sales of services and/or licensing or sales of intangibles.
- *As of 12/31/2025:* Only 10 states continue to the COP method for the 2025 tax year.
 - 2 of these 10 states have enacted market-based sourcing provisions that become effective in subsequent tax years.
 - Some COP states unofficially apply market-based sourcing especially during audits.

Revenue Sourcing: Identifying the Market

How Do States Define the “Market” to Source Revenue?

- States vary widely in how they define a taxpayer’s market and the criteria they use to determine market location.
- States may define a taxpayer’s market differently based on revenue type, customer type and industry.
- Some states determine a taxpayer’s market by reference to the taxpayer’s direct customers.
- Some states look through to the taxpayer’s customer and focus on the taxpayer’s customer’s customers.
- Some states use both methods depending on revenue type.

Revenue Sourcing: Market Language Variations

Common Market Sourcing Terminology

- Most states define the market by reference to one of the following locations:
 - Where the **benefit is received** by the customer
 - Where the **service is received** by the customer
 - Where the **service is delivered** to the customer
 - Where the **customer is located**
 - Where the **contract is principally managed** from
- However, even states that use the same or similar terminology in their market sourcing laws frequently vary in how they interpret and apply these provisions.

Revenue Sourcing: AL, GA, NC, SC & TN

State	Sales of Services Sourcing Rule
AL	Market-based: Sourced to AL if the service is delivered in AL. Specific rules for individuals and businesses; reasonable approximation allowed if needed.
GA	Market-based: Sourced to GA if the benefit of the service is received in GA; proportionally sourced if split.
NC	Market-based: Sourced to NC if the service is delivered to a location in NC; reasonable approximation or throw-out rule if not determinable.
SC	Income-producing activity: Sourced to SC if the activity is performed in SC; proportionally sourced if split.
TN	Market-based: Sourced to TN if the service is delivered to a location in TN; reasonable approximation or exclusion if not determinable.

Revenue Sourcing: AL, GA, NC, SC & TN

State	Cascading Rules Used?	Description of Guidance and Cascading Rules
AL	Yes	Detailed, cascading rules based on customer type and service nature: direct personal service location, billing address, business location, or commercial domicile, with reasonable approximation if needed.
GA	Yes	Cascading rules: benefit received entirely in GA, proportionally if split, then customer’s business location or billing address.
NC	Yes	Explicit cascading rules: for individuals—actual receipt, reasonable approximation, billing address; for businesses—direct use, contract management, place of order, billing address, with safe harbor for many/low-concentration customers.
SC	No	No formal cascading rules; uses an “income-producing activity” standard based on facts and circumstances, with proportional sourcing if activity is both inside and outside the state.
TN	Yes	Detailed cascading rules, especially for professional services: contract management location, place of order, billing address; for other services, use delivery location or reasonable approximation, with billing address as last resort for individuals.

Polling Question # 3

Which of the following state(s) has(have) NOT adopted market-based sourcing for sales of services?

- A. AL and GA
- B. GA and NC
- C. TN
- D. SC

The Importance of Sales-by-State Data

Understanding How Clients Determine Sales-by-State

- Tax service providers issue PBC requests to clients to obtain the information necessary to prepare the client's federal and state income tax returns.
 - Sales-by-state data is one of the most impactful items requested from the client for state income tax compliance purposes.
 - 38 states use a single sales factor apportionment formula to determine what portion of state income after adjustments will be sourced to a given state.
- Tax service providers commonly accept the sales-by-state data provided by clients at face value with no inquiry into how the client arrived at these amounts, the source data used to generate them and what it represents.
- Failure to inquire and/or conduct some level of due diligence on the data points used by the client to arrive at these numbers may create material risk for the client and result in under or overreporting income to one or more states.
- It is essential that the tax service provider understand the meaning behind those numbers before accepting them as gospel and putting them on a state tax return.

Client Provided Sales-by-State Data

Vetting Client Sales-by-State Data Provides Transparency

- Tax services providers should be diligent and obtain clear explanations describing the client's sales-by-state data each year and the source data used to compute it.
- The information you discover from the client may surprise you; however, it will provide you with the opportunity to consider whether the sales-by-state information aligns with the state market sourcing requirements or if the client would benefit from a revenue sourcing analysis to correct any current or prior year revenue sourcing errors.
- A clear understanding of the sales-by-state data provided by the client is essential to preparing an accurate state income tax return that follows the specific sourcing provisions in the various states.

Client Sales-by-State Information May Fall Short

- Client frequently provide sales-by-state based on customer billing address, customer headquarters or taxpayer's office location that signed the customer.
- Though these methodologies may be correct in some instances, they are frequently inconsistent with state market sourcing provisions.

Polling Question # 4

How confident are you that the sales-by-state data provided by your clients correctly aligns with the revenue sourcing requirements in states where they file tax returns?

- A. Very confident
- B. Somewhat
- C. Not confident at all
- D. I have no idea

SALT Revenue Sourcing Analysis Drives Value for Client

A CASE STUDY

California Revenue Sourcing
Gone Wrong!



SALT Case Study: Facts & Issue

+ Client's Business Operations

- + Workhorse is a business process outsourcing provider headquartered in California.
- + Workhorse provides a range of services, including customer support, back-office services, content moderation and others to companies that prefer to outsource certain business functions.
- + Workhorse's employees deliver these services from key hubs located primarily in the Philippines.
- + Workhorse provides services to several large clients such as DoorDash, Facebook, and Uber.

+ A Curious Discovery

- + California (CA) apportionment percentage is 70% on prior year tax return.
- + Potential issue turns into potential opportunity.
- + SALT proposes opportunity to client

SALT Case Study: Opportunity & Execution

+ Revenue Sourcing Opportunity

- + CA sources sales of services to the location where the “**benefit of a service is received.**”
- + CA defines "benefit of a service is received" as "the location where **the taxpayer's customer** has either **directly or indirectly received value** from delivery of that service." (emphasis added).
- + CA cascading sourcing provisions for service revenue

+ Sourcing Service Revenue Contract by Contract

- + Contract Analysis Example: Uber contract
 - + Services provided & territory covered
 - + Potential “reasonable methods” based on available data

+ Multi-Year Analysis

- + CA has a 4-year statute of limitations
- + File CA amended tax returns for open tax years

SALT Case Study: Project Results

+ For the Client

- + Decreased client's CA apportionment percentage from 70% to 10-12%
- + Decreased client's CA tax liability by \$1.7M over 4-years
- + Recurring annual CA tax benefit by performing revenue sourcing analysis each year

+ For the Firm

- + One-time SALT project revenue: \$125K
- + Recurring SALT project revenue: \$25K per year to perform annual revenue sourcing analysis
- + A very happy client

Open Forum & Group Discussion

Questions + Answers
Comments or Observations
Client Fact Patterns



Presenter Background and Contact Information

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Brandee A. Tilman serves as Director, State and Local Tax at Smith + Howard and leads the firm's State Income Tax Consulting practice. She brings over two decades of experience in multistate income tax and works with public companies, privately held businesses, and tiered partnership structures. Brandee advises clients on a wide range of complex state income tax matters with a focus on controversy management (audit representation, protests, appeals, and settlement negotiations), tax planning, transaction analysis, restructuring, mergers & acquisitions, buy and sell-side due diligence and state tax provisions. Brandee regularly assists clients with nexus studies, revenue sourcing analyses, unitary business evaluations, private letter rulings, voluntary disclosure agreements, and post-acquisition integration. She also consults on personal income tax matters, including state residency planning and nonresident income sourcing. Brandee serves clients in various industries, including media and entertainment, consumer products, e-commerce, software, and professional services. Brandee's previous work experience includes serving as in-house tax counsel for The Walt Disney Company, director at Big 4 and partner at a top 20 firm.

In addition to serving clients, Brandee has been a speaker at various tax conferences, including California Tax Policy Conference, Council on State Taxation, Georgetown Advanced State and Local Tax Institute, Tax Executive Institute (TEI), and Institute for Professionals in Taxation (IPT). She has published various SALT articles and co-authored a Bloomberg (formerly BNA) Tax Management Portfolio on Film and TV Production. Brandee also previously served as Editor-in-Chief of The Tax Lawyer – State and Local Tax Edition.

Brandee received her B.A. in economics from the University of Colorado at Boulder, her J.D. from University of California, Davis School of Law and her LL.M. in taxation (with distinction) from Georgetown University Law Center. Brandee is a licensed attorney in California and is admitted to practice before the United States Supreme Court.