ACCOUNTING & FINANCIAL WOMEN'S ALLIANCE

State Tax Duo: Current SALT Hot Topics For Sales Tax And Income Tax

Presented by:
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&
Monika Miles | Miles Consulting Group

Experience | Knowledge | Relationships | Insight

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MULTI-STATE TAX SOLUTIONS

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- "25 Most Powerful Women in Accounting" by CPA Practice Advisor (2012, 2013, 2014 and 2015)
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- "Outstanding Achievement" Award by AFWA 2013

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LET'S START WITH SALES TAX!

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Topics for Today – "The Lucky 7"

- General sales tax concepts/nexus
  - The New Landscape since *Wayfair*
- Retroactivity issues
  - Remedies (VDA & Amnesty)
- Marketplace Facilitators - new rules
- Compliance
- Taxing Services
  - Sourcing
- Technology issues
- Sales tax for M&A

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A LITTLE BIT OF HISTORY

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The concept of sales tax is prevalent in daily conversations because:

- States Need Revenue
- Increased **On-line Transactions**
- Smaller companies are able to expand their sales footprints quickly because of increased technology.
- *There's been some national media and a US Supreme Court Case (South Dakota v. Wayfair – June 2018)!*

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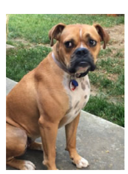
Why CPAs Should Care:



- Who is managing sales tax for your client?
  - Controller? CFO? Bookkeeper?
- What happens when they get a notice?
- It's more than just local compliance!
- Sales tax is different than income tax, but in many ways just as complex

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…Your client is thinking…

"Wait a Minute?! Doesn't my CPA firm have this all handled?"

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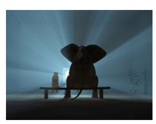
There may be risk to your firm

Recent article in February 2019 issue of Journal of Accountancy:

Addressing risks related to the TCJA and Wayfair

"If a client is unable to collect the tax from its customers, it may ask its CPA to pay the liability, including the tax! It's easy to see how claims in this area may become expensive."



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NEXUS & *SOUTH DAKOTA VS. WAYFAIR (JUNE 2018)*

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The Concept of Nexus - History:

- "The sufficient connection that an entity must have in order for a state to impose a tax."
- Generally physical contact between a taxpayer and state must have occurred.
- Defined by U.S. Constitutional principles and U.S. Supreme Court cases.

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Economic Nexus

A minimum amount of sales $$ or transactions creates nexus

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US Supreme Court – *Wayfair* Decision Overturned *Quill*

- In June 2018, ruled 5-4 in favor of South Dakota
- Sales in excess of $100,000 or 200 transactions can create economic nexus, in SD (varies by state); most have passed economic nexus statutes
- Physical presence test no longer has to be met
- So…nexus is easier to trip into

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Nexus – OK, Now What?

- Once nexus is established, seller is obligated to collect sales tax.
- Unless there is a specific exemption.

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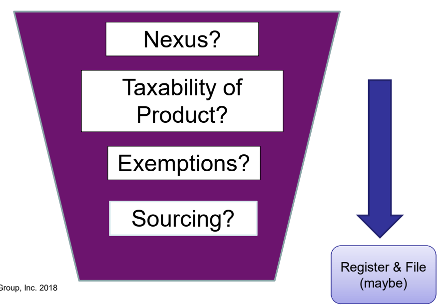
Sales Tax Quick Decision Tree



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WHAT ABOUT RETROACTIVITY?

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What About Retroactivity?

- Most states that have adopted an economic nexus standard have said they won't go back retroactively.
- But it's now 2019 – many of those required filing in October, November, December of 2018.
- **There is some potential for retroactive liability for both economic nexus AND physical presence.**
  - **Example – FBA warehouses…**
  - **What are you going to do about it?**

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What is Your Start Date?

If you had physical presence in the past and are now trying to become compliant, what is your "start date"?

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Remedies

- Perform a nexus review
- Determine taxability of products/services
- Quantify risk and exposure
  - "XYZ" letters
  - Validity of exemption certificates
- Implement a plan to correct deficiencies
  - VDA
  - Amnesty

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Remedies: Need a life jacket?

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Voluntary Disclosure

- Most states allow companies to enter into voluntary disclosure agreements ("VDAs")
- The advantages include a reduced look-back period, abatement of penalties and ease of getting into the state's system.
- Must use a 3rd party

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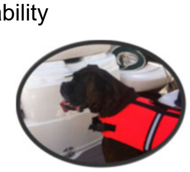
Amnesty Programs

- States offer limited penalty (and sometimes interest) abatement
- Limited scope; limited applicability
- Use caution
- Consider other taxes



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MARKETPLACE FACILITATORS

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Online Marketplaces/Facilitators

- Refers to companies who assist in driving goods to market in the online world.
- Examples include Amazon, Etsy, eBay
- This is good for businesses
- It makes for interesting state tax challenges!

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Online Marketplaces/Facilitators

- In addition to Wayfair legislation, states are enacting Marketplace Facilitator legislation
- Based on volume of sales in the state; similar to Wayfair limits
- Will require the Marketplace Facilitator to register, collect & remit (rather than the seller)

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Online Marketplaces/Facilitators

States which have passed legislation and effective date has already occurred:

AL, AR, AZ, CA, CO, CT, DC, IA, ID, IN, KY, MA, MD, ME, MN, ND, NE, NJ, NM, NV, NY, OH, OK, PA, RI, SC, SD, TX, UT, VA, VT, WA, WI, WV, WY

States have passed legislation and

Effective date is in the near future (2020): HI, IL

States which are not yet on board:

FL, GA, KS, LA, MI, MO, MS, NC, TN

*** Red = As of 10/1/19**

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Online Marketplaces/Facilitators

Some Other Issues for Sellers:

- Where is your inventory?
- If you have inventory, you have physical presence = nexus
- Impacts income tax & sales tax
- Selling directly from your website in addition to the Marketplace.

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Stretch Break?

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REAL LIFE RELEVANCE!
COMPLIANCE CHALLENGES

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Collecting & Remitting = Compliance

Compliance 101

- Nexus? ☑
- Rate? ☑
- Exemptions? ☑
- Registration ☑
- Forms - Electronic vs. Paper ☑
- Due Dates (vary) ☑

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A Few “OOPS”!

- Oops #1: Not filing where we need to
- Oops #2: Unclear on possible exemptions
- Oops #3: Improper documentation
- Oops #4: Collected sales tax and not remitted

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SERVICES – SUBJECT TO SALES TAX?

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What about Services?

- In general, unless otherwise exempt, **sales of TPP** are subject to sales tax.
- In general, unless specifically enumerated, **sales of services** are exempt

BUT

- States are increasing enumerated services or broadening the definitions

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Sourcing Services

- Can be sourced to where benefit is received

OR

- Sourced to where the service is performed

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Some Examples of Taxable Services

- Landscaping
- Fabrication
- Data Processing
- Information Services

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SOME TECHNOLOGY ISSUES

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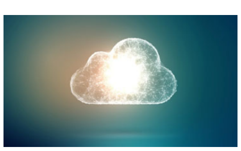
Software-as-a-Service

(SaaS or Cloud Computing)



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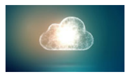
Taxability of SaaS

Companies selling a cloud-based, SaaS solution can be treated differently for tax purposes depending upon what the state thinks it is.

- Is it software or a service?
- What does a state think?
- Where is it being used?



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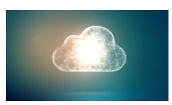
In the Cloud

State taxability positions vary:
- Not an enumerated taxable service
- Not a sale of software (TPP) because no transfer
- Not taxable because server is not in-state
- Taxable information, communication, or data processing service
- Taxable sale of software



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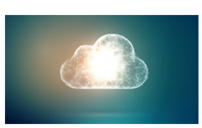
In the Cloud

SaaS - Issues with Sourcing of Revenue

- Bill To Address?
- Ship To Address?
- Where benefit is received?



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MERGERS & ACQUISITIONS

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Thinking about Acquisition?

Due diligence

- Sales tax is often an exposure area
- Could hamper a deal

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Possible Exposure Example

$10-million software company, HQ in CA, selling into multiple states:

$10,000,0000
X 3 years
$30,000,000
X 50% outside CA
$15,000,000 – sales w/possible exposure
X 50% through resellers
$ 7,500,000
X 8% average sales tax rate
$600,000 – possible exposure

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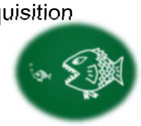
M & A Considerations

- Due diligence – review sales and use on either side of the deal
- Nexus/taxability review
- Remedy the situation before the deal
- Ideally review within 1 year of acquisition



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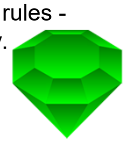
Practical Gems

- Have documentation for all significant transactions.
- Evaluate your nexus situation regularly to determine possible exposure - particularly if your company's plans include merger/acquisition.
- States are reaching further, changing rules - keep up with changes in your industry.



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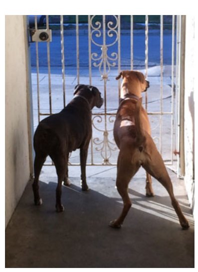
Some Final Thoughts



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Why Do You Need SALT Services?

Examples of Projects that Your Current Clients May Need:

- Nexus Review
- Taxability Review
  - Unique Products
  - SaaS and other Technology
- M&A Transactions
  - Due Diligence

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Some Final Thoughts

Miles Consulting is a resource for CPAs:

- Monthly newsletter
- Weekly topical blog
- ½ hour complimentary consultation for any client (mention webinar)
- A little peace of mind!

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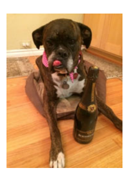
In Summary



- It's a crazy, interesting time
- States are aggressively pursuing revenue (really!)
- Wayfair is impacting almost every one of our clients
- Multi-state companies have interesting issues (and usually need help)
- We recommend to hire a professional!

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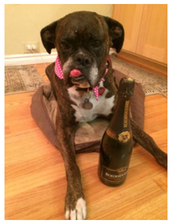
Questions?



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Thank You!

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State and Local Tax Income Tax Hot Topics

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1. Increased Focus on Economic Nexus

- Not a new concept
- A direct result of the *Wayfair* case but economic nexus for income tax has been around for a while
  - 2006 MBNA and Lanco cases
- Currently, largely due to *Wayfair,* it is spreading to different tax types
- Complicating matters nexus standards are different depending upon tax type

wayfair

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Traditional Income/Franchise Tax Nexus

Historically for taxpayers with multistate operations:

- Income tax filing requirement if have people, property, sales in a state – *generally* some physical connection
- PL 86-272 provides protection from income taxation when activities are limited to the solicitation of sales of tangible personal property (protected activities)
- PL 86-272 protections do not apply to:
  - Sales of tangible personal property when the sales person goes beyond mere solicitation such as order taking;
  - Sales of intangibles and services;
  - Taxes that are not based on net income (e.g., capital based taxes and gross receipts taxes)

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Economic Nexus

- Two basic types of economic nexus: subjective v. bright line
- Under subjective standards a state presumes nexus if a company has sales to customers or purposeful direction of business towards a state
  - Vague definitions of "doing business"
  - De minimus or trivial activities or substantial and routine
- Under bright line standards a state presumes nexus if sales, payroll, or assets in the state are over a certain threshold "bright line"

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Economic Nexus Bright Line Thresholds

State	Threshold		
	Sales	Property	Payroll
Alabama	$500,000	$50,000	$50,000
California (indexed - 2018)	$583,867	$58,387	$58,387
Colorado	$500,000	$50,000	$50,000
Connecticut	$500,000		
Hawaii	$100,000		
Michigan	$350,000		
Nevada (Commerce)	$4 million		
New York	$1 million		
Ohio (CAT)	$500,000	$50,000	$50,000
Oregon (Corp. Activity Tax)	$750,000	$50,000	$50,000
Pennsylvania	$500,000		
Tennessee	$500,000	$50,000	$50,000
Texas	$500,000		
Washington (B&O)	$285,000	$57,000	$57,000

HI, OR & PA – effective 1/1/2020

TX- proposed effective for returns due 5/15/20

WA – effective 1/1/2020, Sales only $100,000

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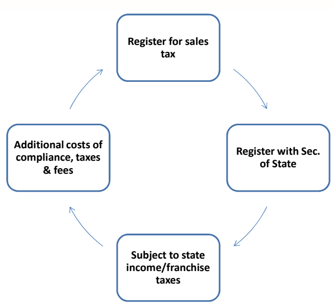
Effects of Registering for Sales Tax



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2. Sourcing of Receipts

- Sourcing of different types of receipts
- Tangible property sourced to state shipped
- Sourcing services depends on State
- Sourcing of intangibles
- Consider Software as a Service or Royalties on Intangibles- generally where the software is used

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Moving to Market based sourcing

- Generally two ways to source sales of services
  - 1) where the cost of performance is located; were service is performed, or
  - 2) Market based sourcing attributes the sales of services and intangibles to a state if the taxpayer's "market for the sale" is in that state. The method of determining a taxpayer's "market for the sale" varies by state based upon:
    - Where the benefit is received;
    - Where the service is received or delivered; or
    - Where the customer is located.
- Consider how to source sales of SAAS software or online services or third party services
  - Multi uses
  - Where customer is headquartered
- Issue is where a company is in two states that source differently

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3. Trend to single sales factor

› Single Sales Factor

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Apportionment Factor Changes

› History: UDITPA adopted the 3 factor (sales, payroll and property)
› States are moving to single sales factor or double/triple weighting sales factor
  › EX CA in 2014
  › This increases tax on out of state companies, can decrease tax for in state if they have a lot of out of state sales

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Apportionment f=Factor Changes

- Why has there been such a dramatic change?
  - Emphasizes market
  - Encourage investment
  - Economic changes
- Impact is it increases the importance of sourcing
  - Market based vs cost of performance
  - Consider throw back or throw out sales in numerator or denominator of sales factor
- This coupled with market based sourcing can be a double hit to an out of state company if unaware of these changes

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4. Pass through non resident withholding

- Many states require nonresident income tax withholding from state sourced income
- Withholding requirements is an entity level tax and can be an issue during a merger or acquisition

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Pass through non resident withholding

- Exemption-file a composite return for non-resident shareholders or partners, some states do not allow or require an application
- Exemption with a signed waiver or certificate from non resident shareholder or partner
- Watch out for taxation of guaranteed payments for partnerships- some states require apportionment of the income

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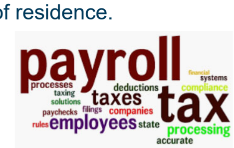
5. Payroll non resident withholding

- General Rule
- Wages are taxable to employees in the state in which **services are performed**.
- Need to consider this for traveling employees who are working out of state of residence.
- Exceptions to consider:
  - De Minimis Rules
  - Reciprocal Agreements



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Increased Enforcement

- Real life cases of increased enforcement by States
  - NJ delivery employee
  - NC employees of a client
  - Confirmation with conversations with payroll roll companies

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Multi-State Withholding- Reciprocal Agreements

- For ease of administration, some states have agreed not to tax residents of another state, who receive income as a nonresident from sources within its state
- Reciprocal agreements generally involve states sharing a common border
- General Rule: Tax income only in the state of residence (as opposed to the state in which services are performed)
- Need to collect a Certificate of Non-Residence for the Work State

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6. Conformity to Federal Tax laws

- Bonus depreciation 100% vs 50%
- Section 179
  - No conformity section 179
  - No conformity to increased limitations still at $25,000
- New Section 163j interest expense limitations
- Repeal of Section 199 Domestic Production Activities
- Changes to NOL
- Conformity to Foreign provisions, GILTI, repatriation rules

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7. Changes for IRS limit on tax deduction Schedule A taxes

- For pass through entities- multi state business taxes can be limited on individual returns to $10,000
- New CT entity tax
- New election for Oklahoma S corporation

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OTHER CONSIDERATIONS

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Sales Tax Reserves - ASC 450 implications

- An estimated loss from a loss contingency, such as a sales/use tax liability, shall be accrued by a charge to income (or capitalized to an asset) if both of the following conditions are met:
  - It is probable that the liability has been incurred at the date of the financial statements and
  - The amount of the liability is reasonably estimable

These rules are also applicable to other non-income taxes such as gross receipts, VAT, property, premiums, duties, etc.

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Yes, states find remote businesses

- Visits to trade shows or conferences
- Audit of in state businesses
- Company trucks driving through states
- Information on Websites
- Comparing registrations with Dept. of tax filings
- Traveling sales persons
- Information in the news
- Random nexus questionnaires
- Auditors stumble on your website
- Becoming more and more creative

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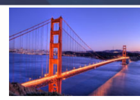
Local License Requirements



- Economic Nexus
  - Philadelphia Business Income and Receipts Tax
    - Income Tax Component
    - Gross Receipts Component
  - San Francisco Local Taxes and Portland, OR sales tax
  - NY MTA

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What you can do to stay on top of nexus?

- Be proactive in evaluating state/local requirements – where are you/your clients REALLY doing business- talk to sales and marketing folks
- Find out where large customers or where services are used, may need to contact customers
- Start filing if recently became taxable in a state
- Consider Tax Amnesty programs if you have outstanding liabilities – known or unknown
- If large exposure for multiple years – consider voluntary disclosures

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In Summary

- Lots of changes due to economic nexus
- Monitor Nexus
- Important to plan for the future: exit strategy or M&A
- Need to consider state nexus for audited financials
- Properly document **income** and **sales** tax positions and correspondence with clients

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What questions do you have?

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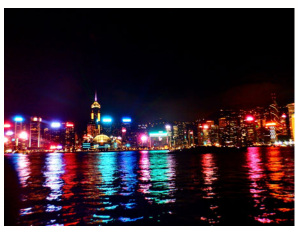
Thank you!



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