Workshop C

Basic: State & Local Tax
... an Introduction to SALT & Multistate Taxation

Tuesday, January 26
1:45 p.m. to 2:45 p.m.
Biographical Information

Michael R. Baker, Michael Baker Associates
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Mike has more than of experience in state and local tax matters. He provides consulting services in multi-state corporate income taxation and planning, sales and use tax matters, as well as other transaction-based issues. His expertise also includes representation of clients during tax examinations and appeals. He serves a variety of clients focusing on manufacturing, consumer products and the financial services industries.

Mike began his career as an attorney with the Ohio Department of Taxation and has been in public accounting the last fifteen years including ten years with Big Four firms. Mike has authored numerous articles and is a frequent speaker on state and local taxation topics.

Professional Affiliations and Activities
- Member, Ohio Bar Association
- Member, Ohio Chamber of Commerce Taxation Committee

Education
- Bachelors of science in accounting, Bowling Green University
- J.D. from Capital University Law School

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Bob Woolley is a Partner with Plante & Moran, PLLC and serves as the State and Local Tax Leader of Ohio. He specializes in multistate tax consulting services related to sales and use tax, income and franchise taxes, property taxes, gross receipts taxes, and the Michigan Business Tax, with a focus on solutions to minimize overall state taxes.

Bob has more than 23 years of experience in state and local tax issues serving a diversified client base ranging from manufacturing to service companies. Bob is a member of the AICPA, the Ohio Chamber of Commerce Tax Committee, the Ohio Society of CPAs, the Michigan Association of Certified Public Accountants (past member of its State and Local Tax Task Force). Bob is also a regular speaker at both internal and external conferences.

Education
- Walsh College, Masters of Science in Taxation
- Michigan State University, Bachelor of Arts, Accounting

Professional and Community Activities
- American Institute of Certified Public Accountants
- Michigan Association of Certified Public Accountants
- SALT Task Force Member (2004 – 2009)
- Ohio Society of Certified Public Accountants
- Planning Committee for Ohio Tax Conference
- Tax Policy Committee of the Ohio Manufacturers’ Association
25th Annual Ohio Tax Conference
(Workshop C)

State and Local Tax Basics: an Introduction to SALT & Multistate Taxation

Bob Woolley – Plante & Moran, PLLC
Michael Baker – M. Baker Associates

January 26, 2016
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Phone: 614.222.9160 Email: Bob.Woolley@PlanteMoran.com
Speaker Biography – Michael Baker

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- Mike began his career as an attorney with the Ohio Department of Taxation and has been in public accounting the last fifteen years including ten years with Big Four firms. Mike has authored numerous articles and is a frequent speaker on state and local taxation topics.

- **Phone:** 216.798.3265 **Email:** MikeBakerLaw@Gmail.com
Goals of Session

- Provide a broad overview of state tax issues
- Discuss various examples to illustrate points
Multistate Taxation basics
One activity, multiple taxes
Apportionment methods and impacts
Financial reporting issues
Audit Exposure
Sales and use taxes issues
Local taxes
Credits and incentives – overview
Overview of doing business in a multistate format
• Multiple locations
  ▪ Identifying nexus due to property and payroll in a state
  ▪ Understanding the tax scheme in each state and its impact on operational planning
  ▪ Increasing compliance burden due to likelihood of additional local filing obligations
    ▪ PPT returns, local taxes, multiple sales tax permits
Overview of doing business in a multistate format
  • Out-of-state or traveling sales people or technicians
    • Tracking where they travel
    • Understanding their roles and authority
    • Recognizing frequency of changes
    • Assessing impact on Company filing requirements
    • Considering the influence on activity profitability
Overview of doing business in a multistate format
- Other activities
  - Telecommuters
- Officers
- What is the impact on nexus?
- What you don’t know CAN hurt you
Multistate Taxation

Types of taxes

- Income
  - Starting point is usually federal taxable income
  - Subject to state specific adjustments
    - IRC conformity
    - Decoupling from IRC
      - DPAD
      - Bonus Depreciation
  - Separate state depreciation rules
Types of taxes

- Franchise
  - Usually based on equity
  - Sometimes based on greater of equity or capital employed in state, i.e. TN
  - Watch for adjustments, i.e. Related Party debt and reserves
Types of taxes

• Gross Receipts
  ▪ Usually low rate
  ▪ Usually no deductions, but perhaps some exemptions
  ▪ Often filed like a sales tax, i.e., WA B&O Tax
  ▪ Watch for local gross receipts taxes, i.e., PA, WV
Multistate Taxation

Types of taxes
- Sales/Use
  - Different nexus standards than other taxes
  - Have to watch for local tax components
  - Exposure for failure to collect
  - Shifted burden from customer to your company
  - Statute of limitations may not start if company isn’t filing
  - Can be a nightmare to comply
Multistate Taxation

- Types of taxes
  - Other?
    - Margins taxes, i.e. Texas Margins Tax
    - Business license fees
      - Often local in nature
      - Easily overlooked
Nexus
• What is it?
  • Term used to describe the types of contacts necessary to establish a state’s right to impose a tax obligation
  • Often misunderstood and assumed to be the same everywhere
  • U.S. Constitution – Due Process and Commerce Clauses
Multistate Taxation

- **Nexus**
  - Is it the same for all taxes?
    - Differences
    - Depends on the type of tax
    - Depends on the jurisdiction
    - May depend on the year at issue
    - Statutory (P.L. 86–272) and Judicial Limitations
Nexus

- What is economic nexus?
  - Generally a state’s determination of nexus because Company avails itself of the state’s markets.

- For example:
  - Ohio deems a company to have nexus for its Commercial Activities Tax if the company has “Bright Line Nexus”
  - Michigan deems a company to have nexus for the Michigan Business Tax if a company actively solicits in the state and has gross receipts of $350,000
  - California, tax years beginning on or after 1/1/2011, if sales to CA exceeds $500K or 25% of taxpayer’s total sales
Multistate Taxation

Nexus
Tracking and determination of Nexus

- Monitor company activity, including employees, sales people and agency relationships
- Service and technical people
- Installation, both internal and arranged
- Observe for changes in activities and structure
Multistate Taxation

Nexus

• How often can nexus change?

• Once created, typically exists for duration of tax period under consideration
  • Calendar or fiscal year for net income and gross receipts taxes

• Some states would say that it sticks for certain time after, i.e. WA B&O goes for three years

• May be impacted by registration to do business or being licensed in the state
Entity level vs. owner level taxation

- C Corporations
  - Taxed at the entity level
- Pass-through entities
  - S Corporations
  - Income generally is taxed at shareholder level
  - Some states have a separate S election, thus, if not made, company is still taxed as a C corporation in that state, i.e. NY, NJ
  - Some states have opt out elections, i.e. WI, PA
  - Some states still have an entity level tax, i.e. CA taxes the S corp income at 1.5% in addition to shareholders being taxed
Entity level vs. owner level taxation

- Pass-through entities
  - Partnerships and LLCs taxed as partnerships
    - Income generally is taxed at partner/member level
    - Some states still have an entity level tax,
      - Ex: IL has an entity level replacement tax
      - Recognize entity level taxes where flow-through treatment is unavailable.
        - Ex: TN, TX (additional tax)
        - Ex: OH’s CAT
Multistate Taxation

- S Corporations – 32 states have withholding requirement
- Partnerships/LLCs – 32 states have withholding requirement
P.L. 86–272

- What is it
  - Federal law from 1959
  - Prohibits imposition of a net income tax if company only perform protected activities
  - Protected activities, in general:
    - Solicitation of orders for sales of tangible personal property
Multistate Taxation

- P.L. 86–272
  - Is it still in effect?
    - Yes, but with diminished applicability

- When does it and doesn’t it apply
  - Applies if only selling tangible personal property
  - Does not apply if selling services, or a mix of services and tangible personal property
  - Does not apply to taxes other than net income tax, i.e., franchise, gross receipts, sales/use
Unitary/Combined filings/Consolidated

- Required vs. optional
  - Some states provide for required unitary filings
    - Ex: CA, MI, TX
  - Some states permit optional combined or consolidated filing
- Many states have provisions where its Department of Treasury mandates combined or consolidated filing if it better reflects activity in the state
Multistate Taxation

- Unitary/Combined filings/Consolidated
  - Nexus only
    - Some states with unitary or combined filing requirements only permit the inclusion of entities with stand-alone nexus
      - If entity would not have nexus on its own, exclude
    - *Finnegan vs. Joyce*
      - Differentiates how apportionment is computed with respect to the sales factor
        - **Joyce** – Only include sales in the state if that entity has nexus
        - **Finnegan** – Include all sales in the state regardless of nexus
Multistate Taxation

❖ Trends
  • Use of alternative tax structures
  • Movement towards economic nexus
    • Exporting tax base to companies locate outside the state but maintaining a market in the state
    • Often combined with alternative tax structure outside of net income tax
  • Increase in unitary filing requirements
  • Increasing burden of compliance
Multistate Planning

- Planning

  - Understanding tax impact before doing business in a state
    - Cost vs. increased profit from activity
    - Impact on taxability of other activities
    - Change to tax structure in other states
    - Unitary filing issue impacting multiple entities
Planning

- Multiple entities
  - Depending on states, may permit reallocation of income to lower tax states
  - Need to be aware of unitary rules
  - Need to watch for related entity add-back provisions
Planning

• Withdrawing from a state
  • Until completely withdrawn, some states continue imposing taxes.
  • Often filing a final tax return does not satisfy withdrawal requirements
    • Surrender authority to do business
    • Does not imply tax clearance
  • Often needs to be done before end of the year to qualify for the next year.
  • May impose significant burden on time, resources
Multistate Planning

Planning
• Understanding exposure with opportunities
  • Be wary of false sense of security because activity is being taxed in another state already
  • Example of common error
    • Sales sourced to State A, assuming sales do not belong to State B
    • Statute of limitations expires, State A apportionment is overstated
    • State B initiates an audit, sources State A sales to its state
    • Company forfeits benefit of reflecting change in State A
Planning

- Understanding exposure with opportunities

- Is the position taken in State A going to influence a position in State B more than the savings in State A

- For example, use of MTC apportionment in State A, but not State B and State B comes back and makes the company use MTC consistently. Did you get what you wanted?
Apportionment

How do states tax the same activity under different tax structures?

• Apportionment
  • Method utilized to determine portion entity’s activity taxable in a specific state
  • Problem is that not all the states use the same rules
  • State tax base varies
    • Net Income vs. Net Margin vs. Gross Receipts
How do states tax the same activity under different tax structures?

- Relief provisions
  - Most states provide a generic relief provision in the statutes
    - Permit requesting use of alternative apportionment method
    - Must prove method better reflects activity in the state
  - Use of the MTC default provisions of three factor, equal weighted apportionment
  - Evaluate holistically
How do states tax the same activity under different tax structures?

- Entity vs. Owners
  - Apportionment method may be different for owners and the entity
    - Ex: MI MBT vs. MI Income Tax
  - Credits available to owners and entities not often the same
Same sale, different treatment

- Tangible goods

- Throw-back and throw-out issues
  - **Throw-back**: sale into a non-nexus state is included in the numerator as a sale in the state or origination
  - **Throw-out**: sale into a non-nexus state is removed from both the numerator and denominator of the sales factor
Apportionment

- Same sale, different treatment
  - Tangible goods
    - What is destination?
      - Ultimate destination – Where are the goods coming to rest
      - Place of delivery (Dock sales) – Where is customer taking possession
  - Sales to U.S. Government
Apportionment

❖ Same sale, different treatment
  • Services and other non Tangible Goods sales

  • Multiple concepts used to determine in which state a sale should be included in the numerator for apportionment

  • Recommend having a process as opposed to letting an auditor determine
    • Company understands its business better than auditors

  • Should document your process for determining to be prepared for an audit inquiry
Apportionment

- Same sale, different treatment
  - Services and other non Tangible Goods sales
    - Determining the proper Income Producing Activity (IPA) is vital
Same sale, different treatment

- Services and other non Tangible Goods sales
  - Cost of performance
    - Determine where a greater portion of economic activity occurred for inclusion of sale in state apportionment
    - Usually an all or nothing test – one state gets the sale
    - Greater than any other state (highest % state wins)
    - Greater than all other states (>50% in one state)
  - Understanding what is included in costs is important, i.e., do you or don’t you include subcontractor costs
Apportionment

- Same sale, different treatment
  - Services and other non Tangible Goods sales
    - Benefits received
      - Concept of determining where the consumer receives the benefit of the services provided
      - Can be very subjective
      - Newer concept with little guidance
Same sale, different treatment

- Services and other non Tangible Goods sales
  - Time Spent
    - Concept that revenue is proportional to the time spent in the state performing the service
    - Does not account for value of time spent
Apportionment

- Same sale, different treatment
  - Services and other non Tangible Goods sales
    - Personal services
      - Certain states have provisions related to personal services
      - Often buried deep in statute or regulation
      - Need to understand state’s definition of “personal services”
  - Special rules
    - Transportation
    - Financial organizations
    - Rental and leasing
Same sale, different treatment

- Impact of differing sourcing rules amongst states
  - Double or triple counted sales
  - Example:
    - Services performed 10% in OH (Benefits received), 20% in CA (Time Spent), and 70% in MA (Greater Cost of performance)
    - IPA is $100,000 and customer is in OH
    - OH sales factor includes $100,000 (benefit received is in OH at customer location)
    - CA sales factor includes $20,000 (20% of $100,000)
    - MA sales factor includes $100,000 (70% is greater cost of performance, thus all or nothing)
    - Results in $220,000 being included in sales factors or 220% of total sale
Apportionment

- Same sale, different treatment
  - Impact of differing sourcing rules amongst states
    - Nowhere sales
      - Example:
        - Services performed 70% in OH (Benefits received) and 30% in MA (Greater cost of performance)
        - IPA is $100,000 and customer is in GA
        - No nexus in GA
        - OH sales factor includes $0 (benefit received is in GA where customer is located)
        - MA sales factor includes $0 (30% is not greater cost of performance, thus all or nothing)
        - Results in $0 being included in sales factor because no nexus in GA
Pass-through apportionment

- Corporate owners
  - Unitary
  - Often treated as business income
  - Often proportional amount of apportionment factors combined with corporate owner
- Non-unitary
  - Often treated as non-business income
  - Proportional income or loss by state is added to apportioned business income, or just included as income subject to apportionment based simply on corporate owners factors
Apportionment

- Pass-through apportionment
  - Non-Corporate owners
  - Business vs. non-business

- Trends
  - Single sales factor
  - Benefits received sourcing for service income
Financial Reporting Issues

- ASC 740–10 (FIN 48)
  - High level overview
  - How are companies addressing
  - Differences depending on entity type
  - Change in risks from state detection
    - New IRS reporting requirement
    - How much detail needs to be reported

- IFRS
Audit Exposure

What is changing and what are we seeing

- More hiring by the states to support increased audit activity
- Increase in specialization of auditors
- More audit outposts

How to handle

- Good cop or bad cop
- Internal or external
Audit Exposure

- When to get help
  - Internal expertise
  - Historic audit results
  - Complexity and Scope of Exposure
Sales and Use Taxes

- Nexus issues
- New reporting requirements
- Audit trends
- Taxes on services
  - Could be the wave of the future
  - More states considering to meet budget shortfalls
  - What happens with B2B?
  - How will it all be sourced
Local Taxes

- What don’t you know can hurt you
  - Know where you have physical presence
  - Use your customers for information

- How do you keep up?
Credits and Incentives

❖ How much money is out there
  • Depends on the state
  • Often statutorily limited on an annual basis

❖ How do I get a piece
  • Spend time in advance
  • Don’t announce anything to the public
  • Use state and local resources
  • Don’t commit to anything
Credits and Incentives

Law vs. reality

- Often left to the discretion of a state economic development group
- Negotiation often has more to do with result than actual statutory definitions
- Political in nature, appeal of agreement in a brief press release

Who do I trust

- Should I use a contingent fee firm
- Should I use my regular CPA
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