Workshop JJ

Transactions in Today’s Economy: State Tax Implications of How We Do Business

Wednesday, January 25, 2017
11 a.m. to 12:30 p.m.
Biographical Information

Kimberly A. Hensley, CPA, Senior Manager - Indirect Tax, DSW Inc.
810 DSW Drive, Columbus, OH 43219
kimberlyhensley@dswinc.com  614-872-1288

Kimberly is a Senior Tax Manager at DSW, responsible for the Indirect Tax function of the $2.6B shoe retailer. Her responsibilities include sales and use tax, personal property tax, unclaimed property and credits/incentives. In her role, her product knowledge and immeasurable Vertex background have been critical to the company’s implementation of its current use tax system, and will be integral in the company’s upcoming implementation of its new cloud-based Point-of-Sale register system. The ever expanding landscape of the customer omni-channel experience has required her to be on the forefront of many challenges all retailers are facing, most importantly multistate nexus. Recently, she played an essential role in DSW’s acquisition of Ebuys, Inc., a leading e-commerce off-price footwear and accessories retailer, in March 2016.

Ms. Hensley has a well-rounded perspective on state and local taxation gained through an extensive 22-year indirect tax career in an array of industries, including retail, e-commerce, wholesale, manufacturing, real estate trust, utility and telecommunications. She has experience in tax research, audit management, and subsequent state tax controversy resolution.

Kimberly received her Bachelors of Art Degree in Accounting from Ohio Wesleyan University.

Susan Haffield, Partner, PricewaterhouseCoopers
45 South 7th Street, Minneapolis, MN
susan.haffield@pwc.com  612-596-4842  Fax: 813-282-6152

Susan Haffield is a partner in the Minneapolis office of PwC. Susan provides consulting services focusing on indirect tax strategy, audit defense, refund analysis, structures, sales tax reserves, process improvements, e-commerce, and nexus evaluations. She also specializes in indirect taxes associated with the retail and consumer products industries. Susan has been actively involved in the Business Advisory Council of the Streamlined Sales Tax initiative.

Susan has also been involved with many other business and taxpayer organizations such as the, Minnesota Chamber of Commerce, Minnesota Center for Fiscal Excellence, and Minnesota Society of CPA’s. She is a frequent speaker for organizations such as Council on State Taxation, Ohio Tax Conference, Paul J Hartman SALT Forum, Institute for Professionals in Taxation, Tax Executive Institute, and New York University.

Susan has over 30 years of experience. In addition to her experience in public accounting, Sue was a manager in the Cargill tax department where she focused on indirect taxes and state and local income taxes. She joined PricewaterhouseCoopers in June 2002.

Michael Lake, Executive Director - State & Local Tax, Ernst & Young, LLP
312 Walnut St. Ste. 1900, Cincinnati, OH 45202
michael.lake@ey.com  michael.lake@ey.com

Michael Lake is an Executive Director in the Cincinnati office and serves as the market leader for Indirect / State and Local Tax Services for the Cincinnati/Dayton, Indianapolis, Columbus, and Louisville offices of E&Y. Michael has extensive experience with all aspects of indirect taxation and specializes in state income/franchise tax and sales/use tax planning. Michael has served in various roles throughout his career, including performing refund reviews for over 75 companies. Michael also has significant experience with structuring transactions as well as internal reorganizations. He has work with companies in the manufacturing, chemical, retail, pharmaceutical and services industries. Michael has spent 20 years providing tax consulting services in the public accounting sector. Michael is a member of the Ohio Society of Certified Public Accountants and the AICPA.
Transactions in Today’s Economy: State Tax Implications of How We Do Business

Susan Haffield
PwC
Minneapolis, MN
susan.haffield@pwc.com

Kimberly Hensley
DSW
Columbus, OH
kimberlyhensley@dswinc.com

Michael Lake
E&Y
Cincinnati, OH
michael.lake@ey.com
Agenda

State Tax Issues Associated with New and Evolving Business Models

• Internet of Things
• Sharing Economy
• Retail-Omni Channel and Services
• Direct to Consumer Models
• Utilities-Alternative Energy
Internet of Things
Internet of Things
General

Refers to the development of the Internet whereby everyday objects have network connectivity allowing them to send and receive data

Some examples include:
- Garden sensor—the sensor analyzes sunlight and soil conditions and alerts the owner the needs of the plants
- Smart refrigerators—evolving to generate shopping lists, play music and display calendar
- Cars—numerous features
Internet of Things
General

• Devices are generally imbedded with electronics, software, sensors, and network connectivity
• Increased focus on intangibles
• Need to protect the technology
• Business practices-eg, license agreements for intangible components
Internet of Things
Sales/Use tax considerations

• Invoicing separately for technology component may dictate taxability
• Bundling may result in tax imposed on non-taxable components
• Revenue recognition changes may impact tax collection requirements
  • Newly converged standard between FASB and IASB
  • Effective for 2018
  • Requires assignment of revenue to each “performance obligation” under a contract
Internet of Things
Example: Sale of an Automobile

• Digital Millennium Copyright Act (DMCA).

• Previously, internet piracy legislation but could make working on your own car illegal.

• Listing the vehicle as a “mobile computing device”

• What car manufacturers and even tractor manufacturers argue is that you don’t actually own your vehicle. Rather, you’re sort of just borrowing it for an extended amount of time and paying for the rights to use the technology.
Internet of Things
State income tax considerations

• Will invoices and purchase contracts for things you buy include separate terms for the “right to use” the intangibles

• Sourcing of Sales
  • Sales of Tangible Personal Property (TPP)
  • Sales other than the sale of TPP – software, service features, monitoring.
    • Market sourcing vs. Cost of Performance (COP)
    • For COP states, where were the costs incurred to develop the intangible components (not the overall tangible item)
    • For market states, where is the benefit received or do you know

• State income tax nexus considerations
  • P.L. 86-272 applies only to those who sell TPP exclusively (along with certain other limitations)
Internet of Things
State income tax considerations

Assuming some component of what is sold contains software and must be sourced separately.....

• Is it a perpetual license?

• Is it a software subscription service?
  • on‐sight or remote support
  • Updates
  • Customer Service

• Is it software as a service (SaaS)?
  • On Demand

• What is being sold informs how to source the sale
  • COP question - Where were the costs incurred to develop or maintain the software (not the entire item, but the software)
  • Market question - where is it used (where is the benefit received) or was there even a benefit that was received
Sharing Economy
Sharing Economy

What is the “Sharing Economy?”

• Socio-economic trend
• Involves a “peer-to-peer” sharing of goods and services
• “What’s mine is yours for a fee”
• Enabled by technology to reduce transaction cost and expand very quickly
Sharing Economy
General

Goods/Service Provider
- Offers a good or service (for example pet sitting for a vacationer)
- Can accept or reject requests based on their own schedule
- Does not collect payment from customer

Concept Developer
- Operates website for the particular good or service
- Responsible for background checks or other necessary quality requirements
- Collects payment from customer and pays provider less service fee

Customer
- Contacts ‘concept’ developer via website
- Reviews offerings and selects particular service provider
- Remits payment to concept developer
- Is connected to provider for performance of the service
Sharing Economy
Restaurant Example

Restaurant
- Contracts with market provider to place menu on website
- Prepares food for pick up by provider
- Prices food sold to customer
- Does not collect payment from customer

Market Provider
- Operates website for multiple restaurants
- Collects payment from customer
- Picks up food from restaurant and delivers to customer

Customer
- Uses provider’s website to select a restaurant and place an order
- Makes payment to provider
- Receives food at requested location
Restaurants
Cases and Rulings

_Crimson 2 Go, LLC v. Alabama Department of Revenue_, Alabama Tax Tribunal, July 7, 2016

- Taxpayer operates a website that sells prepared food from a variety of local restaurants
- Taxpayer processed the orders, took payment, and collected tax on the prepared food. Tax collected was provided to each restaurant for remittance
- Taxpayer arranged for the pick up and delivery of the food to the customer, but no tax was collected on the delivery fee
- DOR assessed Taxpayer for the tax on both the delivery and the prepared food
- ALJ disagreed with the DOR noting that Taxpayer was not the seller of the food, and therefore, the delivery charges were also exempt.
Sharing Economy
Sales/Use tax considerations

• Seller of record/collection responsibility—Food preparer does not interact with the customer or collect payment; and food delivery service doesn’t prepare the food

• Tax rate considerations—Restaurant may not be aware of customer’s location; collects tax at rate in the restaurant

• Taxability issues—Delivery charges (not included in tax base by restaurant)

• Numerous local taxes on restaurants (eg, in entertainment districts)
Sharing Economy
State income tax considerations

• Do we really tax sharing? Yes, when it comes at a price!

• What does the contract say? Is there one, multiple or no transactions?

• Who is the customer and where are they benefitted?
  • Does Airbnb get paid entirely by renter and then reimburse property owner or does the renter pay the property owner and Airbnb in separate transactions
  • Logistics broker – are they reimbursed by the retailer for delivery or by the end user. Who is the customer?

• Issues arise similar to the “internet of things”
  • How to source the sale
  • Who is the customer, and where does that customer receive benefit?

• Other unique issues
  • Gross or net sales in the sales factor
  • Nexus considerations – making a market
Retail
Omni-Channel Retail

**TRADITIONAL**
The good, old-fashioned bricks and mortar store

**E-COMMERCE**
Online shopping has skyrocketed in recent years

**MULTICHANNEL**
Various, disconnected channels for customers to use independently

**OMNICHANNEL**
An integrated, seamless experience across multiple devices and touchpoints
Omni-Channel Retail General

• Ordering capabilities are 24/7 and tailored to customer demands
  • Out of stock in store/order online

• Multiple fulfillment options to suit customer needs
  • Buy in store, ship elsewhere
  • Buy on-line, pick up in store
  • Retail distribution centers

• Options to return product to stores/DCs

• Use of third parties
  • Fulfillment
  • Websites/Marketplaces
Omni-Channel
Sales tax considerations

• Point of sale systems - retail vs e-commerce sales
• Rate of tax to charge
• Taxability decisions - delivery charges and additional services
• Advertising and sales on multiple platforms
  • Drop shipments
  • Nexus
• Loyalty programs
Omni-Channel
Sales tax considerations

Point of Sale Systems

• E Commerce tax calculation system is generally separate from POS at store locations

• Store POS systems are generally programmed to single store location
  • Tax rate issues associated with ordering at the store and shipping elsewhere
  • Tax rate issues associated with returned merchandise from other locations

• Legal entity issues
  • If sales and returns are co-mingled among legal entity, sales tax reporting issues may need to be resolved on audit
Omni-Channel
Sales tax considerations

Rate of Tax to Charge

• Origin vs. Destination
  • Where is the order placed
  • Where is the order accepted
  • Where is the order shipped from

• AZ, CA, IL, MO, NM, OH, PA, TN, TX, UT, VA
Omni-Channel
Sales tax considerations

Advertising and Sales on Multiple Platforms

- Third party advertising
- Click thru advertising could create nexus in localities where there is no store location
- Drop shipment issues
- Seller of record issues
- Tax collection proposals related to third party fulfillment/website operators
  - NCSL model language
  - AZ Ruling TPR 16-3
Omni-Channel
Sales tax considerations

Nexus

• South Dakota Quill Challenges
  • See also; Alabama and Tennessee Economic Nexus Standards

• D.M.A. vs Brohl – US Supreme Court denied cert., 12/12/16

• Online Sales Tax Simplification Act
Loyalty programs

- The treatment of transactions associated with the redemption of points varies among the states, and potentially, the type of loyalty program
- Points may be treated as a discount; and redemption would therefore reduce sales price
- Points may be treated as consideration; and the full sales price for the item would be used as the tax base
- Programs with multiple parties (e.g., teaming of awards between grocery stores and gas stations) could be treated similar to a manufacturer’s coupon
- Membership fees; taxability often depends on benefits received
Omni-Channel
Sales tax considerations

Minnesota Revenue – Sales Tax Fact Sheet 167

Guidance provides varying treatment of points depending on type of program:

• Charge sales tax after the discount is applied for:
  ◦ Rewards Cards, Punch Cards, Seller’s Cash

• Charge sales tax before the reward is applied for:
  ◦ Secret Shoppers, Hostess Rewards, Credit Cards Points, Bundled Rewards
Omni-channel
State income tax considerations

• Omni-channel retailers are a focus of many state income tax authorities
  • Are physical presence nexus standards giving way to bright line nexus standards?
  • Single sales factors (in place of 3 factor apportionment) impact retailers
  • Credits and incentives routinely focus on centralized capital and high wage jobs

• Other considerations for retailers
  • From the retailers perspective, are vendor rebates considered sales or reductions to COGS?
  • Are rebates sourced differently than the underlying product sold?

• From the distributors perspective, do I really know where a sale is destined?
  • Retail customer’s store or their warehouse?
  • Where is the “ultimate destination” of the sale
## Summary of 2016 Legislation

**Key:** Green – enacted; Red – dead; Purple – vetoed; Black – proposed

**As of 29 November 2016**

### Repeal/phase-out tax
- Corporate income/franchise: GA (net worth tax); MS (phase-out franchise tax), NH (business profits tax), TN (phase-out Hall income tax)

### Rates
- Increase: Corporate income: OR; Personal income: AK (new tax), CA (voter sustained increase), IL, WA (new tax); Sales/use: LA, MO (voter sustained increase), OK, SD, WV; Other business tax: LA (telecommunications), MA (ride sharing); OR (transient lodging tax)
- Decrease: Corporate income: DC (as part of tax relief plan), FL, ID, LA, MD, MS, NY (business franchise tax) PA, VA; Personal income: GA, ID, LA, MS, OH; Sales/use: NJ, WA; Other: MS (insurance premium tax)

### Nexus
- Sales/use Affiliate/remote retailers: ID, LA, MA, MN, NE, OK (notification, voluntary), RI, UT, VT
- Sales/use Economic nexus: CT, RI, SD, VT
- Income/Franchise Economic nexus: MS

### Income tax
- Market sourcing: CT, LA (2nd Special Session), MD, NM, OR, VA
- Single sales factor (SSF): CT (expand current rule), DE, LA (2nd Special Session), MD, MA, UT (extends SSF election), VA
- Combined reporting: AL, FL, IN, KY, MD, NJ, PA; Study combined reporting: IN
- Tax havens: AL, CO, IL, KS, KY, ME, MA, MN, NJ, PA
- Miscellaneous: Limit NOLs: LA, Related party add-back: LA, NC, VA (REIT Dividend received deduction); Limit deductions/credits: LA; Delay FAS 109 deduction: DC

### Sales tax
- Tax services: CA, RI (ride sharing), WV, OK; MO (voter approved measure prohibits tax on services)
- Digital goods: AL, PA
- Expand base/eliminate exemptions: LA, MO, OK
- Expand exemptions: CT, FL, IA, MO, UT

### Property tax
- Property tax relief: ID, NE, UT
- Assessment/valuation: IL, IN, NM; Dark Store: MI

### Controversy
- Amnesty program: AZ, CA, GA, PA
- Economic substance: MN, WI
- Modify penalty provisions/interest rate: AL, GA, MD, OK, TN, WI
- Miscellaneous: CO (repeal pay-to-play); KY (return not same force as a regulation); NY (reportable transactions); SD (RARs), WY (refund procedures)

### Other
- Limit tax credits: AK (oil and gas), LA, NJ, NY, OK
- Create/expand credits: AL (jobs), DE (R&D, jobs), GA (various), IA (R&D), NJ (grant allowed as credit); SC (energy); TN (various) VA (R&D)
- Study/review credits: AL, CT, HI, MD, OK
- Unclaimed property: AZ, CA, FL, IL, MI, PA, WY
## Economic nexus standards

<table>
<thead>
<tr>
<th>State</th>
<th>Economic nexus standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>AL</td>
<td>Doing business if AL sales exceed $500,000, payroll or property exceed $50,000, or 25% of any of the three is in AL</td>
</tr>
<tr>
<td>CA</td>
<td>Doing business if CA sales exceed $509,500, payroll or property exceed $50,950, or 25% of any of the three is in CA</td>
</tr>
<tr>
<td>CO</td>
<td>Doing business if CO sales exceed $500,000, payroll or property exceed $50,000, or 25% of any of the three is in CO</td>
</tr>
<tr>
<td>CT</td>
<td>The taxpayer actively solicits sales in CT and has CT sales of $500,000</td>
</tr>
<tr>
<td>MI</td>
<td>The taxpayer actively solicits sales in MI and has MI sales of $350,000</td>
</tr>
<tr>
<td>NH</td>
<td>Substantial economic presence standard</td>
</tr>
<tr>
<td>OH</td>
<td>Doing business if OH sales exceed $500,000, payroll or property exceed $50,000, or 25% of any of the three is in OH</td>
</tr>
<tr>
<td>OR</td>
<td>Significant economic presence standard</td>
</tr>
<tr>
<td>TN</td>
<td>Doing business if TN sales exceed $500,000, payroll or property exceed $50,000, or 25% of any of the three is in TN</td>
</tr>
<tr>
<td>WA</td>
<td>Substantial nexus if WA sales exceed $250,000, payroll or property exceed $50,000, or 25% of any of the three is in WA. Applies to wholesalers starting on 9/1/2015.</td>
</tr>
<tr>
<td>WI</td>
<td>Directing business to the state standard</td>
</tr>
</tbody>
</table>
Direct to Consumer Models
Direct to Consumer Models
General

• Traditional sales model is for manufacturer to sell to a wholesale or retail distributor

• Direct to consumer changes supply chain to “bypass” the distributor

• New model often compensates the distributor
  • Manufacturer may develop a website that interacts with distributors
  • Manufacturer may develop a website that allows commission for distributor
Direct to Consumer
Sales tax considerations

- Manufacturer develops website for consumers for certain products (e.g., parts)
- Distributors' information is included and customer selects a distributor based on location or product availability
- Manufacturer sells product to distributor but may ship directly to customer
- Alternatively, distributor ships from its own inventory based on instructions from manufacturer
- Distributor is seller of record
Direct to Consumer
Sales tax considerations-Distributor Sale

<table>
<thead>
<tr>
<th>MANUFACTURER</th>
<th>DISTRIBUTOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Must be capable of collecting tax during the payment process</td>
<td>• Must add online sales to in store sales for sales tax reporting</td>
</tr>
<tr>
<td>• Must have sales tax footprint of each distributor</td>
<td>• Must consider how to address online sales made outside sales territory</td>
</tr>
<tr>
<td>• Must have a means to report the tax to the distributor for inclusion on</td>
<td>and/or local jurisdictions</td>
</tr>
<tr>
<td>returns</td>
<td>• Must have exemption certificates on file for audit</td>
</tr>
<tr>
<td>• Must address exemption certificate process</td>
<td></td>
</tr>
</tbody>
</table>
Direct to Consumer Sales tax considerations-Commission

- Manufacturer develops website for consumers for certain products (e.g., parts)
- Distributors' information is included and customers select a distributor based on zip code or personal preference
- Manufacturer sells and ships the product to the customer
- Manufacturer provides a commission on the sale to the distributor selected by the customer
- Manufacturer is the seller of record
Direct to Consumer

Sales tax considerations—Commission

• Manufacturer must be capable of collecting tax directly from consumer
• Issues regarding product returns if handled by distributor/refunding sales tax
• Must gather and maintain exemption certificates
• May be required to collect tax on the commissions paid to distributors (eg, NM)
Direct to Consumer
Income Tax Considerations

• New revenue streams many times result in new supply chains
• Sales sourcing of product (how do I track order to an infinite number of customers rather than a finite number of distributors)?
• Direct to consumer models can impact transfer pricing
  • Ex: if a company makes an intercompany sale from its manufacturing entity to its distributing entity, what should that price be?
  • Impacts separate return states
• From the distributors perspective, commissions raise new nexus concerns
  • P.L. 86-272 protections impacted
Utilities/Alternative Energy
Utilities/Alternative Energy
Solar energy

Diagram:
- Solar panel converts sunlight to DC current.
- Extra electricity credited on grid.
- Take electricity your home requires.
- Inverter converts electricity DC to AC.
Utilities
Solar energy

Customer
- Purchases solar panels for their home
- Generates power from solar panels that is placed on the grid
- Uses power provided by the public utility’s system but could use more or less than what is produced from the solar panel

Public Utility
- Assists customer in getting the solar power to the grid
- Provides two meters; one for the power generated by the solar panel, and one for the power consumed by the customer
- Collects payment from customer for net amount-known as “net metering”
Utilities

Solar energy gardens

Gulf Solar Energy Share
A community solar program for Gulf Power customers.

Credit on your bill
Customers receive a monthly credit on their bill for the electricity generated by their subscribed share of the solar facility.

Subscription
Customers pay an annual subscription of $99 to participate.

Community solar facility
Solar panels installed in sunny locations to produce renewable energy that goes onto the grid.
Utilities

Solar energy gardens

**Solar Garden**
- Sells “subscriptions” to participate in the community solar garden
- Responsible for building out solar generating power

**Public Utility**
- Works with solar garden on build out and getting the power to the grid
- Continues to supply power, including the power generated from solar garden
- Collects payment for electricity from customer
- Provides customer with monthly bill credit

**Customer**
- Purchases subscription to support the solar garden to receive a prorated share of solar garden output
- Continues to buy and use residential energy
- Receives a proportional monthly bill credit for kwh associated with
Utilities
Sales Tax Implications

• Solar gardens
  Is the sale of the initial subscription fee for the right to receive power in the future a taxable event?
  • Nontaxable-intangible right to receive solar power
  • Nontaxable-solar power is exempt from tax
  • Taxable-constitutes prepayment for electricity
  • If taxable-do customer/use-based exemptions apply?
What is the impact of the bill credit for the solar power purchased during a given month?
  • Retailer’s discount
  • Treated as consideration

• Consumer solar panels
  • “Net metering”—should utility collect sales tax on the power actually consumed; or the “net” amount
  • The sale of electricity is either the sale of TPP or sale of a service-what did the utility provide?
QUESTIONS?