
State and Local Tax Update - 2014

Presenters:

Akash Sehgal
Green Hasson Janks LLP
(310) 873-1622
asehgal@greenhassonjanks.com

December 5th, 2014

SALT Update – 2014

Agenda

State Income Tax Trends
Sales/Use Tax Trends
Tax Haven Treatment
Recent Cases/Legislation

State Income Tax Trends



More Aggressive Nexus Approaches

Economic Nexus

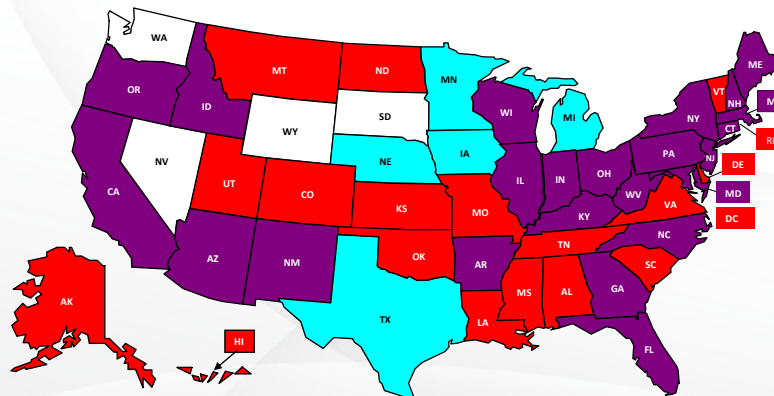
- Many states not longer require a physical presence (i.e., property or payroll) within the state to establish nexus
- Companies which generate income from licenses, royalties or trademarks should consider whether these activities create nexus in a state

Factor Presence Nexus

- Generally the state has a minimum threshold of receipts, property or payroll in order to create nexus
- California sales exceed \$500,000 and/or California sales exceed 25% of total sales
- California, Colorado, Connecticut, Ohio, Washington

NOTE: Protection under P.L. 86-272 always trumps physical, economic or factor presence nexus.

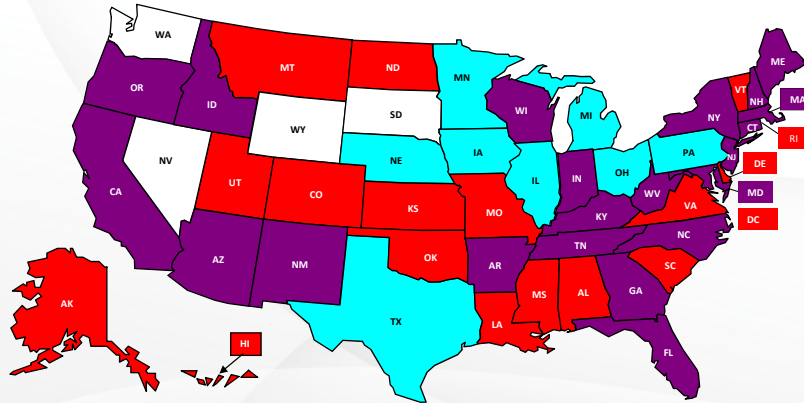
Apportionment Formulas - 1998



- Equally weighted three factor formula
- Double weighted sales factor
- Triple or greater weighted or single sales factor

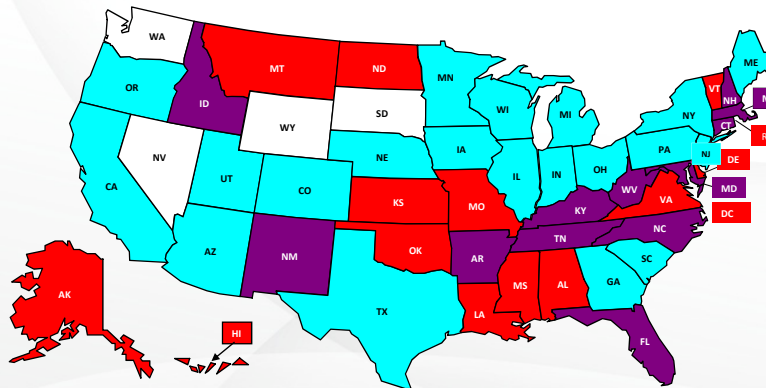


Apportionment Formulas - 2003



- Equally weighted three factor formula
- Double weighted sales factor
- Triple or greater weighted or single sales factor

Apportionment Formulas* - 2014



- Equally weighted three factor formula
- Double weighted sales factor
- Triple or greater weighted or single sales factor



State Income Tax Trends



Market Based Sourcing

- Applies to sales other than the sale of TPP

Prior Rule

- Revenue is sourced to state to the extent the service is performed in the state (i.e. cost of performance)

New Rule

- Revenue is sourced to a state to the extent the customer benefits from the service in the state. Location of service is no longer relevant

Single Sales Factor - Example



Facts

XYZ Company, a C Corporation has 100% of its payroll and property in California. XYZ performs software consulting services for two clients one located in New York and the other in California. 100% of the services are performed in California and XYZ generated \$5 million in revenue from the client in New York and \$2 million in revenue from the client in California. XYZ had taxable income of \$2 million. Both the New York and California clients benefit from the services performed by XYZ in their home state.

Prior Law – 3 Factor Apportionment/Cost of Performance

Under the prior law, XYZ would source 100% of its income to California as it has 100% of its property, payroll and sales allocated to California. Under the prior Cost of Performance sales sourcing method, sales revenue is sourced to the state where a greater cost of performing the services was incurred. Given that 100% of the services were performed in California, 100% of the revenue should be sourced to California.

CA Tax Cost - \$2 million x 8.84% = \$176,800



Single Sales Factor - Examples



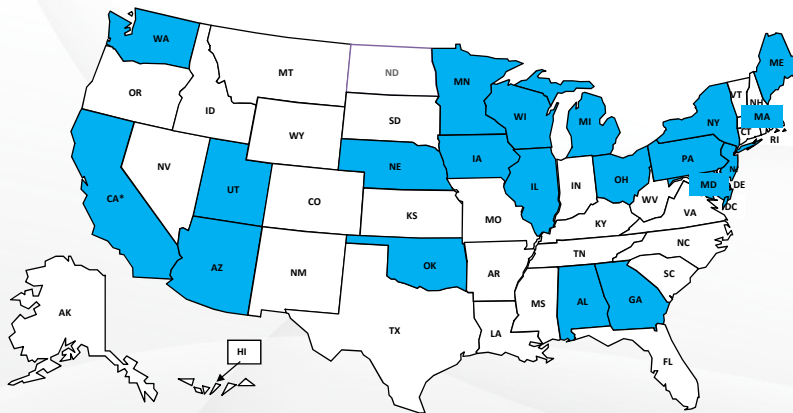
Current Law— Single Sales Factor/Market Sourcing

Under the current law, XYZ does not take into account its property and payroll in determining how much of its revenue is apportioned to California. For sales factor purposes, XYZ sources service revenue based on where its customer benefits from its service. Therefore, XYZ would source \$2 million to California and \$5 million to New York, giving it a California apportionment factor percentage of 40%. XYZ is generally not subject to New York tax as it does not have a physical presence in New York.

CA Tax Cost - \$2 million x 40% x 8.84% = \$70,720

CA Tax Savings Under Current Law = \$106,080

Market Based Sourcing – 2014 and Beyond



Tax Haven Legislation



- A number of combined reporting states have passed legislation over the past few years providing for the potential taxation of related parties located in tax haven jurisdictions
- States have generally addressed the treatment of tax haven entities in one of four potential ways:
 1. Specifically exempt foreign corporations from the combined return to the extent that income generated is US Source FDAP income (e.g. California WE filing and RI)
 2. Specifically exempt the US Source income of a foreign corporation to the extent that the income is treaty protected from US federal income tax (e.g. MA and WI)
 3. Require the inclusion of the US Source income of a foreign corporation to the extent that the foreign corporation is located in a specifically defined tax haven jurisdiction (e.g. AK, MT and OR).
 4. Require the inclusion of the US Source income of foreign corporation to the extent that the country in which the foreign corporation is located meets certain criteria (e.g. DC and WV)

Take Away – States are aggressively looking at ways to combat perceived tax haven tax planning strategies. Practitioners should keep an eye on this legislation and how it affects their clients prospectively.

Sales Tax Trends – Agency/Click Thru Nexus



Determining Nexus

Broader Definition than Income Tax

- Physical Presence
- Agency Nexus
- *No Protection for Solicitation Activities*

What is the Current Trend in Sales Tax Nexus

- Affiliate Nexus
- Click Thru Nexus

Many Companies are Overlooking Sales Tax Filing Requirements – Often Times it is not easy to go back to Customers to collect sales tax.



Sales/Use Tax Trends



▪ Amazon Law

- Vendor Presumption (Solicitation Thru Online Links)
- New York residents provided links to Amazon's website, which New York customer accessed when purchasing products. Amazon was deemed to have click-thru nexus in New York
- Roughly 20 plus states have passed or proposed similar types of laws, so NY's ultimate decision has had significant impact

Remote Seller Reporting Requirements



State Legislation Already Passed

- Seller's without nexus/not registered to collect sales tax to notify purchasers of "use" tax obligation
- Colorado, North Carolina, Oklahoma, South Dakota, Vermont
- As a purchaser are you currently paying "use" tax?

Federal Legislation being Considered

- Standardize the taxation of remote sellers
- Standardize the taxation of digital goods

Sales/Use Tax Trends



Taxation of Emerging Technologies

- Digital Products
- Software as a Service
- Electronically downloaded Software

TPP or Service?

Sales/Use Tax Trends



What is a digital good?

- Tangible Personal Property
 - Data Processing
 - Information Services
 - Telecommunications/Ancillary Services
 - Software
-
- **Why does it matter?**
 - Need to know what it is before we can determine how it will be taxed
 - States moving toward taxation of “digital goods” as new revenue source

Sales/Use Tax Trends



Software as a Service (SaaS)

States are taking different approaches to cloud computing, mainly SaaS at this point.

- Electronically delivered software
- Non-taxable information or data processing service
- Taxable information or data processing service
- Nothing: state does not tax electronically delivered software or information/data processing services

Sales/Use Tax Trends



Do you qualify for an exemption from collecting sales tax?

- Wholesale Goods
- Tax-Exempt Service
- Tax-Exempt Customer
- Qualified Medical Equipment
- Qualified Manufacturing Equipment
- Software delivered electronically vs. on a tangible medium

State Tax Trends



- State Tax Audits are on the Rise (sales tax, use tax, income tax)
- IRS and State Tax Authorities are working together
- Transfer Pricing Adjustments being reported by states to IRS
- IRS Adjustments – Must be reported to States within a certain period of time (30 days – 180 days)
- States are delaying the issuance of refund claims as generally a number of states pay zero interest on refunds (e.g. California)

Recent Legislation/Court Cases



- **US Supreme Court** – *Wynne vs. Maryland*
 - Maybe most important state tax case in last 20 years
 - Deals with the Commerce clause and whether states are obligated to provide for a credit for taxes paid to other states
- **New Jersey** – New legislation targets corporate inversions
- **California** – Certain corporate LLC members not subject to state franchise tax – See CA Legal Ruling 2014-01
- States are aggressively pursuing nonresident withholding on flow thru' s.
- US Congress is heavily looking at the Mobile Workforce Act