The Expansion and Application of State Gross Receipts Taxes

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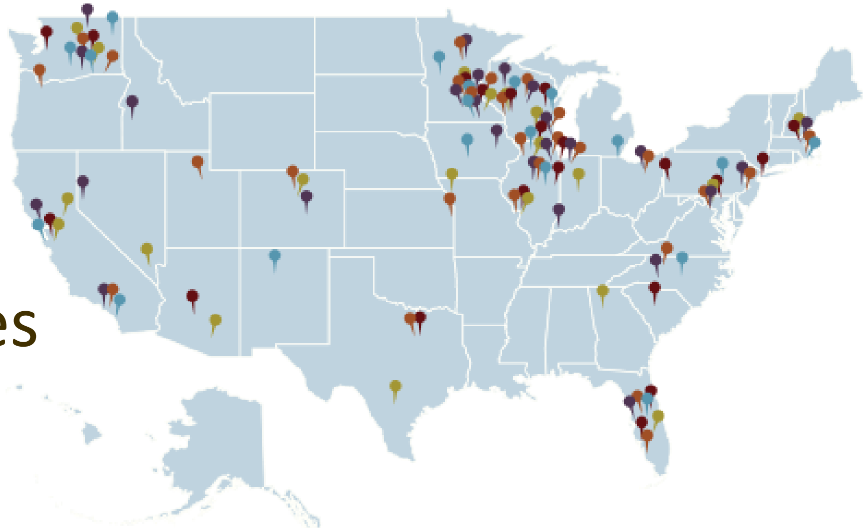

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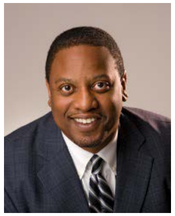
Speaker Introductions

Steven Jensen, CPA, Director

Steve is a state and local tax (SALT) expert with 20 years of experience in both industry and public accounting. He leads CLA's Pacific Northwest SALT practice in the delivery of innovative state and local tax solutions, statute, regulation, and nexus analysis, refunds, and controversy services to technology, retailing, e-commerce, transportation, manufacturing, biotech, and healthcare clients.



Marcus Mims, CPA, Principal

Marcus is a principal in charge of the SALT services for the firm's southwest region, which includes Arizona, Colorado, and New Mexico. He has more than 25 years of public and private experience.

Theresa Mullen, MT, Manager

Theresa is a SALT manager with more than 17 years of tax and accounting experience. She has extensive Ohio state and local tax experience and is a firm resource of these issues. Theresa also has multi-state tax experience in various issues.

Learning Objectives

- At the end of this session, you will be able to:
  - Identify gross receipts taxes and how they apply to business activities
  - Distinguish important differences between gross receipts, income, franchise, and sales/use tax
  - Review the application of state gross receipts tax on multi-state business activities
  - Express recommendations to assist in the resolution of gross receipts tax issues

What are Gross Receipts Taxes?

Steve Jensen – Seattle

What Is a Gross Receipts Tax?

- A GRT is a tax on business receipts rather than business income.
  - Usually imposed on all business sales/activities and allows few or no deductions.
  - Generally simple to implement.

Advantages of GRT's

- Seen as a stable tax because sales typically varies less than income.
- Simple to implement and understand.
- Applicable at a lower rate than most taxes because of the broad base.

Disadvantages of GRT's

- No relation to the amount of government services used.
- Different effective rates between industries.
- Pyramiding of tax.
- Taxes companies that have no income – disincentive for new businesses.
- Often becomes complex due to modifications to counteract different effective tax rates.

Brief History of the GRT

- Gained popularity in the early 1930s as state revenues decreased during the Great Depression
- By World War II, many GRT's were found to be unconstitutional or were repealed
  - DE, IN, WV, and WA retained their GRT's into the 1980's
- The early 2000s saw several new GRT's
  - However, the GRT's in IN, KY, MI, and NJ were quickly repealed
- Are we seeing a rebirth?
  - Relatively new GRT's in NV, OH, and TX
  - WA doubles down with expanded nexus and application

How Are GRT's Different?

- A GRT is not a sales tax
  - A GRT applies at the entity level as opposed to the final transaction
    - ◊ The GRT is not passed on to the buyer
  - Each sale is potentially subject to the GRT
    - ◊ The application of a GRT on sales from the manufacturer to wholesaler to retailer all create a pyramiding of the liability
    - ◊ Sales tax only applies to the final consumer
  - A GRT applies to almost all business activities, including services and sales of intangibles
    - ◊ Sales tax is generally limited to retail sale of tangible personal property and certain retail services

How Are GRT's Different? (cont.)

- Entity-level taxes
  - Unlike an income tax, GRT's apply to pass-through entities, including LLC's and S corporations
- Different nexus standards
  - Since a GRT is not a sales tax, there is not a physical presence requirement (see *Quill Corp v. North Dakota*)
  - OH and WA have adopted factor presence standards that determine whether a company is considered to be doing business in the state
  - No P.L. 86-272 protection because a GRT is not an income tax
- No conformity to federal income tax
- No provisions for entities operating at a loss

Gross Receipts Tax Jurisdictions

Theresa Mullen – Akron/Canton offices in Ohio

Gross Receipts Tax Jurisdictions

- Delaware, Nevada, Ohio, Tennessee, Texas, and Washington have statewide gross receipts tax with varied tax rates.
- However, there are numerous local jurisdictions with a gross receipts tax.
  - West Virginia cities
  - Los Angeles
  - Virginia cities (Business License Tax)
  - Seattle

Gross Receipts Tax Jurisdictions

- Delaware - Delaware's Gross Receipts Tax is a tax on the total gross revenues of a business, regardless of their source. Gross receipts tax rates currently range from .1006% to .7543%, depending on the business activity.
- There are no deductions for the COGS, product costs, interest expense, discounts paid, delivery costs, or taxes.

Gross Receipts Tax Jurisdictions

- Public Law 86-272 protection does not apply to gross receipts tax.
- Include most receipts but few exclusions…however each state can have different provisions.
- Nexus rules

Gross Receipts Tax Jurisdictions

- In 2017, additional states had legislation for gross receipts tax
  - Louisiana, Oregon, West Virginia
  - Horizon? State budget shortfalls (potentially 40 states) could look at gross receipts tax to fill these gaps.

Gross Receipts Tax Jurisdictions

- Not an income tax and is a tax that can be easily overlooked.
- Sales tax and gross receipts tax can be reported on the same form and may cause confusion over who is monitoring and filing the tax.
- Easily triggered. Know where you are doing business, what are the nexus rules and what tax jurisdictions may apply.

Ohio Commercial Activity Tax

Theresa Mullen – Akron/Canton offices in Ohio

Ohio Commercial Activity Tax ("CAT")

- The CAT is an annual tax imposed on the privilege of doing business in Ohio, measured by gross receipts from business activities in Ohio. Businesses with Ohio taxable gross receipts of $150,000 or more per calendar year must register for the CAT.
  - All business types/business forms
  - Related Entity Groups/one annual minimum tax
  - Annual Fee

Ohio Commercial Activity Tax (“CAT”)

- Combined Taxpayer Group
  - The “control test” is that the higher-tiered entity must own more than 50 percent of the lower-tiered entity at each level of the vertical chain and effectively, through its ownership, possess the voting rights to be able to control the lower-tiered entity. Combined taxpayer groups may not exclude receipts between members of the group; however, such groups need only include in the group those members that have nexus with Ohio.

Ohio Commercial Activity Tax ("CAT")

- Consolidated Elected Taxpayer Group
  - The "control test" is that the higher-tiered entity must own at least 50 percent or at least 80 percent of the lower-tiered entity at each level of the vertical chain and effectively, through its ownership, possess the voting rights to be able to control the lower-tiered entity. A major benefit of making this election is that receipts received between members of the group may be excluded from the taxable gross receipts of the group. However, taxpayers making this election must agree that all commonly owned entities are part of the group even if nexus does not exist.

Ohio Commercial Activity Tax ("CAT")

- Bright-Line Nexus
  - A person has a bright-line presence if any one of the following applies during the calendar year:
    - ◊ Property in Ohio is at least $50,000; or
    - ◊ Payroll in this state is at least $50,000; or
    - ◊ Taxable gross receipts sitused to Ohio are at least $500,000; or
    - ◊ 25% of total property or total payroll or total gross receipts is within Ohio; or
    - ◊ The person is domiciled in Ohio.

Ohio Commercial Activity Tax ("CAT")

- Bright-Line Nexus
  - *Crutchfield, Corp. v. Testa*
  - *Diversified Ingredients, Inc. v. Testa*
- Foreign companies selling into Ohio
  - Nexus considerations
  - Audit issue

Ohio Commercial Activity Tax ("CAT")

- Sourcing
  - Sale of tangible personal property
  - Sale of services
    - ◊ CAT Information Release 2005-06 (54 services addressed)
  - Greenscapes Home and Garden Products, Inc. v. Testa

Ohio Commercial Activity Tax (“CAT”)

- Amnesty
  - January 1, 2018 to February 15, 2018 filing period for delinquent taxes due and not paid as of 5/1/17.
  - A qualifying delinquent tax does not include a tax for which a notice of assessment, notice of audit or bill has been issued.
  - No penalty and ½ interest abated
- Voluntary Disclosure
  - No penalty but interest applies

New Mexico Gross Receipt Tax

Marcus Mims – Albuquerque

New Mexico Gross Receipts Tax

- For the privilege of doing business in New Mexico
- Very similar to other states sales tax
- Tax is based on seller's gross receipts
- Compensating tax – companion tax to the gross receipts tax for the privilege of using property in New Mexico (similar to a use tax)

New Mexico

Gross receipts includes receipts from:

- Sales of property in New Mexico
- Leasing or licensing property in New Mexico
- Granting a right to use a franchise employed in New Mexico
- Performing a service in New Mexico (includes construction)
- Selling research and development services performed outside New Mexico, the product of which is initially used in New Mexico.

New Mexico

A seller's gross receipts are presumed to be:

- Taxable
- Deductible – nontaxable receipts that are required to be reported on a taxpayer's gross receipts tax return
- Exempt – nontaxable receipts that are not required to be reported on the taxpayer's gross receipts tax return

New Mexico

Gross Receipts Tax Excludes:

- Tax billed to the buyer
- Cash discounts allowed and taken
- Any type of time-price differential
- Amounts received solely on behalf of another in a disclosed agency capacity

New Mexico

Rate ranges from 5.125% to 8.6875% depending on the location of the business

- Generally, the gross receipts tax rate is based on the business location of the seller or lessor, **NOT on the** location of the buyer or lessee.

Compensating tax rate is 5.125%

New Mexico

Exemption Certificates

- To support certain deductions, New Mexico requires the buyer to issue the seller a Nontaxable Transaction Certificate (NTTC). (i.e. Sales for resale or performing construction)
  - New Mexico does not accept exemption certificates from other states, only NTTC's are acceptable
  - NTTCs differ from normal certificates in that there is a different form for each exemption

Nevada Commerce Tax

Marcus Mims – Albuquerque

Nevada Commerce Tax

- Became effective July 1, 2015
- Imposed on business entities for the privilege of doing business in Nevada
- Business entity includes C corps, partnerships, LLCs, business trusts, sole proprietorships, joint ventures and professional associations
- Imposed on each business entity whose gross income from sources in Nevada exceeds $4M
- There are a number of exclusions and deductions from gross revenue but no deduction for cost of goods sold

Nevada Commerce Tax

- Tax rates vary from .051% to .331% depending on the industry in which the business entity is primarily engaged
- Tax is imposed on a separate entity basis
- Taxable year is July 1 to June 30
- Reports are due within 45 days of tax year end.
- Taxpayers can request a 30-day extension
- Receipts from the sale of services are sourced to Nevada if the purchaser received benefit in Nevada

Nevada Commerce Tax

- An employer is allowed a credit against Nevada's payroll based tax equal to 50% of the Commerce tax paid in the previous year

Washington Business and Occupation Tax

Steve Jensen - Seattle

B&O Basics

- The B&O tax is measured on the value of products, gross proceeds of sale, or gross income of the business.
- Washington, unlike many other states, does not have an income tax.
- Washington's B&O tax is calculated on the **gross** income from activities.
- There are no deductions from the B&O tax for labor, materials, taxes, or other costs of doing business.

What Do You Do?

- Most common rate classifications
  - Retailing .471%
  - Wholesaling .484%
  - Manufacturing .484%
  - Services and Other Activities 1.5%
- If a business performs multiple types of activities it must report and pay on multiple B&O tax rates
- Tax is imposed on each separate legal entity

Don’t Forget the Cities

- 40 cities impose a local B&O tax
  - Seattle
  - Tacoma
  - Bellevue
- The rates are all different and the rules are often completely different than the state rules

B&O Tax and Nexus

- Prior to June 1, 2010, physical presence created
- Services, royalty, wholesaling and retailing nexus
  - No physical presence required
  - Bright line nexus standard
    - $267,000 of gross income (or receipts for Wholesaling)
    - $53,000 of payroll
    - $53,000 of property
    - At least 25 percent of total property, payroll, or income in Washington
  - Effective June 2010 for Services and Royalties
  - Effective September 2015 for Wholesaling
  - Effective July 2017 for Retailing

Attribution of Sales

- Sales of tangible personal property are sourced to Washington if delivery occurs in the state
- Sales of services are attributable to Washington if the benefit of the service is received in Washington
  - ”…the taxpayer will know where the benefit is actually received or a "reasonable method of proportionally attributing receipts" will generally be available.”
  - Cascading method
    - ◊ Reasonable method
    - ◊ State from which customer ordered the service
    - ◊ State to which billing statements are sent
    - ◊ State from which customer sends payment
    - ◊ Etc.

Texas Franchise Tax

Steve Jensen - Seattle

Texas Franchise Tax, aka Margin Tax

- The tax is typically assessed in return for the “privilege” of doing business in Texas
- Applies to nearly all business entities
- Taxable entities that are part of an **affiliated group** engaged in a **unitary business** must file a combined group report.
- The Franchise Tax is a hybrid between a GRT and an income tax

The Basic Calculation

- Start with total revenues and then subtract
  - 30% of total revenue, or
  - Cost of goods sold, or
  - Compensation
- The tax rate is than applied against the lowest taxable "margin"
- The resulting difference is then "apportioned" to Texas, based on the percent of business a company does in the state.

Tax Rate

- Tax Rate
  - 0.75% for most entities
  - 0.375 for qualifying wholesalers and retailers
    - ◊ SIC Code must be for a wholesaler or retailer
    - ◊ Over 50% of revenue must be from wholesale or retail
    - ◊ Taxpayer or affiliated entity can't manufacture over 50% of the products
- If the calculated tax is less than $1,000, no payment is due

Public Information Report

- Each Corporation, LLC, Limited Partnership, Professional Association, Financial Institution that has a franchise tax responsibility, must file a Public Information Report.
- Entities not described above that have a franchise tax responsibility must file an Ownership Information Report

Questions?

Thank you!

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