Multistate Taxation

Korean American CPAs of Greater New York

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Presenter

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Multistate Taxation Overview

- Sales Tax and Use Tax
  - Tax Base
  - Sourcing
  - Exemption

- Income Tax
  - Tax Base
  - Apportionment
  - Filing Methods

Sales Tax and Use Tax

Nature of Tax

- Sales tax is imposed on retail sales of tangible personal property and certain enumerated services in the state
- Use tax is a complementary tax imposed on the storage, use or consumption of tangible personal property within the state

Sales Tax: Major Concepts

- The retailer is responsible for the collection and remittance of the tax to the state
- All retail sales are presumed to be taxable unless:
  - an exemption certificate is provided or;
  - the item being purchased is statutorily exempt

Use Tax: Major Concepts

- Use tax supplements the sales tax and is imposed on tangible personal property purchased from an out of state vendor that is brought into the state for use, storage or consumption
- Use tax was enacted to discourage purchasers from going out-of-state in order to avoid sales tax
- If the retailer has nexus with the taxing state, the retailer is responsible for collection and remittance of the use tax. If the retailer does not have nexus, it is the consumer’s responsibility to remit the use tax.

Sourcing of Sales

- Sales Tax: States' rules for sourcing of sales for sales tax can vary
  - Origin states (usually Seller's location)
    - Example: Texas
  - Destination states (usually Buyer's location)
    - Example: Oklahoma
- Use tax is imposed based upon the buyer's location in both states

Basis of Tax

- Amount of the sale or purchase subject to tax is generally the sales price
- Sales price generally includes the total consideration received with certain deductions, such as:
  - Cash Discounts
  - Bad Debts
  - Returns
  - Seller's Coupons
  - Trade-In

Exemptions: Major Concepts

- Exemptions are granted on the:
  - Nature of the product (e.g., intangibles)
  - Type of transaction (e.g., occasional or isolated sale)
  - Nature of the entity selling or buying the product (e.g., charity)

Exemption Certificates

- Generally, the retailer must either obtain an exemption certificate or collect the tax from the purchaser
- Acceptance in good faith is required
- Retailers are required to maintain exemption certificates on file according to their open statute of limitations

Marketplace Fairness Act

- The federal Marketplace Fairness Act of 2013 (S. 743), would authorize states meeting certain criteria to require on-line and other out-of-state retailers to collect and remit sales and use taxes, even if the retailer has no other physical presence in the state

- The Senate, on May 6, approved the Marketplace Fairness Act of 2013 (S. 743) by a vote of 69-27. The measure is currently before the House of Representatives.

  – Currently, under the current nexus legal framework, because of Constitutional limitations imposed by the Commerce and Due Process Clauses, states cannot require out-of-state retailers to collect sales and use tax unless the company has some physical presence in the state

  – Consumers are required to self-assess and pay use tax, but the reality is that while business use tax compliance is commonly enforced, consumer use tax compliance is inconsistent at best

State Income Tax

State Income Tax Base in General

- Most, though not all states that levy a net income tax, use Federal Taxable Income as starting point
- State taxing statutes make reference to:
  - Current Internal Revenue Code; or
  - Internal Revenue Code as of a specified date (which may result in non-conformity with recent IRC changes)
- States adopting the Internal Revenue Code may also explicitly decouple from specific provisions of the Internal Revenue Code (e.g. the bonus depreciation provisions pursuant to IRC Section 168(k))

State Income Tax Base Calculation

Federal Taxable Income

+/-	Modifications

Total Taxable Income

-	Allocable Non-business Income

Apportionable Business Income

x	*Apportionment Percentage*

Business Income Apportioned to State

+	Non-business Income Allocated to State

State Taxable Income

Formulary Apportionment

- Taxpayer must have a taxable presence in at least one other state to be able to “apportion” business income; otherwise business income entirely taxable in state of domicile
- Business income is formulary apportioned among the states in which the taxpayer does business
  - Apportioned implies a percentage, from 0 to 100%, applied to business income to determine how much of that income is apportionable to a particular state
- Non-business income is allocated to the states from which the income was derived
  - Allocated implies assignment of a specific element of income/loss or expense to a single state

UDITPA

- The Uniform Division of Income for Tax Purposes Act (UDITPA) is a state tax model for allocating and apportioning income among the states
  - Adopted in full or part by approximately 20 states though these states vary in the manner and extent of their adoption of the UDITPA provisions
  - Similar rules used by most other states levying a net income tax

UDITPA 3-Factor Apportionment

- UDITPA apportions business income using an evenly-weighted, three-factor formula of:
  - Property
  - Payroll
  - Sales
- Each factor is expressed as a fraction, with the numerator representing the in-state portion and the denominator the portion everywhere
- Many states have moved to a more heavily weighted sales factor or single-sales factor

Property Factor

- Purpose is to measure taxpayer's degree of presence in a state
- Property is included in the numerator if it is "owned or rented and used in this state"
  - Average property (*cost or net book value*)
  - Rent *times 8* (*net annual rent*)
  - Sourced based on the location

Payroll Factor

- Similar to the property factor, the purpose of payroll factor is to measure taxpayer's degree of presence in a state
- Payroll is generally sourced to the state where the unemployment insurance contributions are paid
- Payroll Factor Issues:
  - Employee vs. independent contractor
  - Included amounts (taxable wages, salaries, commissions, and any other form of remuneration paid to employees for personal services)

Sales Factor

- The sales factor seeks to measure the degree of the taxpayer's customer base within a state
- What is included in "sales" can vary significantly in scope from one jurisdiction to another, particularly with respect to revenue received from the sale of intangible and non-inventory assets
- Sales of tangible personal property are sourced differently from sales of services or intangibles

State Filing Methods

- Separate reporting
- Unitary combined reporting
- Consolidated reporting
- Nexus combination or consolidation

State Filing Method Considerations

- Who is considered the taxpayer?
- Required or Elective Combined/Consolidated Filing?
- Combined/Consolidated state filing groups may differ from Federal consolidated group
- Pre-apportionment tax base aggregation v. Post-apportionment tax base aggregation?
- *Joyce* v. *Finnigan* sourcing rule for sales factor?
- Worldwide v. Water's Edge
- Intercompany Transactions

Questions?

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