SALTrends: Navigating State & Local Tax Savings Opportunities

July 9, 2020

Presenters

Sara Goldhardt, CPA
Director,
State & Local Tax Services
(614) 947-5243
sgoldhardt@gbq.com

Jeff Monsman, JD
Senior Manager,
State & Local Tax Services
(614) 947-5226
jmonsman@gbq.com

Note

1. This presentation is intended to make participants aware of tax issues that may apply to this audience.

2. Information presented herein is not intended to be tax advice.

3. Please consult with a qualified practitioner for tax advice related to specific transactions.

Agenda

- Multistate income tax
- Ohio CAT
- State tax credits
- Sales and use tax
- Real estate tax

SALT Savings Opportunities

State and Local Tax Savings Opportunities

- Businesses typically pay a significant amount of state and local taxes annually.
- Due to COVID-19, business owners and managers are focused on identifying opportunities to conserve cash and recover company assets.
- For multistate companies, where are those opportunities?

Multistate Income Tax

State Income Tax Filing Methodologies

- Separate filing vs. combined reporting (mainly for C corporations).

- The continuing trend is the enactment of required unitary combined reporting.

- Taxpayer advantages of mandatory combined reporting:
  - Reduce compliance burden
  - Eliminate intercompany transactions
  - Utilize net operating losses
  - Dilute apportionment

Multistate Income Tax

State Income Tax Filing Methodologies – cont'd

- Taxpayer disadvantages of mandatory combined reporting:
  - Eliminate separate company state tax planning opportunities
  - Increase uncertainty/complexity
  - Unitary group is not necessarily the same as a federal consolidated return group
  - Finnegan and Joyce states
  - Increase tax base
- What about pass-through entities?
- Recent trend of proposing state income tax at the pass-through entity level

Multistate Income Tax

State Income Tax Apportionment

- States are continuing the trend of a move to single sales factor apportionment.

- Increasing the weight of the sales factor effectively shifts the tax burden to out-of-state companies and may help attract businesses to relocate to the state.

- Close to 30 states have now adopted single sales factor apportionment.

- Taxpayer advantages of single sales factor apportionment:
  - Enable in-state companies to invest in property and people with no penalty
  - Decrease the tax burden on in-state taxpayers
  - Ease tax compliance and administration

Multistate Income Tax

State Income Tax Apportionment – cont'd

- Taxpayer disadvantages of single sales factor apportionment:
    - Increase the tax burden on out-of-state taxpayers
    - Distort in-state activities

- Remember that apportionment provisions can differ in some states between corporations and pass-through entities. For personal income tax purposes, many states still use three-factor apportionment.

- Possible state apportionment strategies

Multistate Income Tax

State Income Tax Apportionment – cont'd

- For sales other than sales of tangible personal property (TPP), states are moving to the market-based sourcing method from the cost-of-performance (COP) method.
- The market-based method better reflects the taxpayer's market and is a benefit for in-state taxpayers.
- Sourcing sales under the market-based method can be difficult. Where is the "market"?
- Approximately 35 states now require market-based sourcing of sales other than sales of TPP (for C corporations).
- Remember that apportionment provisions can differ in some states between corporations and pass-through entities. For personal income tax purposes, many states are still using COP sourcing.
- For the remaining COP states, which COP method is used?

Multistate Income Tax

State Income Tax Apportionment– cont'd

- Taxpayer advantages of market based sourcing:
    - Reduce tax base for in-state companies
    - Create "nowhere" sales
- Taxpayer disadvantages for market based sourcing:
    - Create double taxation
    - Defining "market"
    - No federal protection (e.g., Public Law 86-272)
- Will COVID-19 impact COP sourcing for 2020?

Multistate Income Tax

State Income Tax Apportionment– cont'd

Example 1:

Company X is an IT consulting company located in Virginia. All of Company X's services are performed in Virginia. Company X performs a consulting project for Company Y which is located in Ohio. Company X bills Company Y $100,000 for the project. To where is the sale sourced?

- Virginia will say $100,000 should be sourced to Virginia.
- Ohio will say $100,000 should be sourced to Ohio.
- This is an example of double taxation.
- If the scenario was the opposite – work performed in Ohio for a customer in Virginia – the sale would be a "nowhere" sale.

Ohio Commercial Activity Tax

Situsing Sales of Tangible Personal Property

- Gross receipts sitused to Ohio if purchaser "ultimately" receives tangible personal property in Ohio (R.C. 5751.033(E)).
- Terms of sale and title passage do not impact where the sale is sourced.
- The place the property is ultimately received after all transportation has been completed.
- Location must be known by the seller at the time of the sale. See Ohio Information Release CAT 2005-17.
- Recent Ohio CAT cases regarding "ultimate destination"
- *Greenscapes Home and Garden Products, Inc. v. Testa,* 2019-Ohio-384 (February 7, 2019)

Ohio Commercial Activity Tax

Situsing Sales of Tangible Personal Property – cont'd

Example 1:

ABC Computers sells $600,000 of computers to Retail Store. Retail Store requests all property be shipped to its distribution center in Columbus, Ohio (not a QDC). Retail Store ships the computers to its stores throughout the Midwest.

- Where are the $600,000 of receipts sourced?
  - Is it known at the time of delivery how many of the computers will be shipped to Ohio stores?
  - What shipping documentation exists to support this?

Ohio Commercial Activity Tax

Situsing Sales of Tangible Personal Property – cont'd

Example 1 – cont'd:

Assume at the time of delivery ABC Computers labels and packages computers according to their final destination. $100,000 of these sales will ultimately be received by Ohio stores.

- ABC Company will have $100,000 of CAT taxable gross receipts related to this sale.

In general, if there is no way to document end destination outside of Ohio at the time of sale, entire $600,000 is considered to be an Ohio taxable gross receipt.

Ohio Commercial Activity Tax

Situsing Sales of Services

- Purchaser's physical location of use or benefit is paramount in determining if service receipts sourced to Ohio
- Gross receipts proportionally sitused to Ohio based on purchaser's benefit in Ohio compared to purchaser's benefit everywhere
- Reasonable, consistent, and uniform manner for determining benefit may be used at the election of the service provider*
- *Defender Security Co v. Testa,* Ohio S.Ct. No. 2019-0531

** If the Tax Commissioner disagrees with a taxpayer's method, a penalty will not be imposed if the situsing was found to be made in good faith.*

Ohio Commercial Activity Tax

Situsing Sales of Services – cont'd

Example 2:

Realty Co. provides management services for companies that lease unused space. Realty Co. manages billing, mailing and cash receipts for the companies. All of these services are performed in Ohio. Realty Co. received a $1M management fee related to a leased property in Florida.

- Where are these management service receipts sitused?
    - The benefit of the services are received in Florida. Therefore, these management fees are sourced outside Ohio for CAT purposes.

Ohio Commercial Activity Tax

Situsing Sales of Services – cont'd

Example 3:

Data Co., located in Columbus, Ohio, provides data processing services for Indiana Company, located in Indiana. All services were performed in Ohio. These services totaled $100,000.

- Where are the $100,000 of receipts sitused for CAT?
  - 100% Indiana. The benefit of the services is received in Indiana.

Assume the services are performed for Indiana Company's accounting department which is located in Cincinnati, Ohio. All services were performed in Ohio. These services totaled $100,000.

- Where are the $100,000 of receipts sitused for CAT?
  - 100% Ohio. The benefit of the services is received in Ohio.

Consistent reasonable method can be used.

Ohio Commercial Activity Tax

Agency Exclusion

- An "agent" is a person authorized by another person to act on its behalf to undertake a transaction for the other.

- To determine if an agency relationship has been established, the following three factors must be present:
    - The agent is required to act in the owner's best interest
    - The agent has an agreement in writing that states that the agent is acting as the owner's agent
    - The agent acts as a conduit with respect to payments made under the agreement

- An agency relationship does not exist in a lump sum contract.

- *Willoughby Hills Development and Distribution, Inc. v. Testa,* Slip Opinion No. 2018-Ohio-4488 (Ohio S. Ct. Nov. 7, 2018).

Ohio Commercial Activity Tax

Agency Exclusion – cont'd

Example 4:

Realty Co. charges each tenant common area maintenance fees. The fees are based upon the square footage leased. Realty Co. uses these fees to pay for landscaping, snow plows, etc. The total common area maintenance fee collected is considered a CAT gross receipt unless an agency relationship exists. Typically, the relationship between the lessor and lessee is not strong enough to be considered an agency relationship.

Ohio Commercial Activity Tax

Agency Exclusion – cont'd

Example 5:

General contractor ("GC") establishes a cost-plus contract with property owner. The GC will receive cost plus 5% for each subcontractor used. The GC is required to act in the owner's best interests with respect to cost issues. GC has an agreement in writing with the subcontractors that states that the GC is acting as the owner's agent and not as an agent of the subcontractor. The GC acts as a conduit with regard to any payments made to the subcontractors. For Ohio CAT purposes, GC can exclude the receipts that the GC receives from the owner to pay the subcontractors. However, the 5% fee retained by the GC is an Ohio taxable gross receipt for CAT.

State Tax Credits

Ohio Commercial Activity Tax

- Qualified Research Expense Credit
  - Nonrefundable
  - 7 year carryforward
  - Generally calculated after Federal R&D credit is determined

- Jobs Creation Tax Credit (JCTC)
  - Refundable
  - Multiple factors considered: payrolls, capital investments, competition, etc.

- Make sure that all applicable credits are being claimed on the CAT return.

State Tax Credits

Ohio Income Tax Credits

- Ohio Opportunity Zone Tax Credit
  - The Ohio Opportunity Zone Tax Credit provides a nonrefundable tax credit against the individual income tax for Taxpayers that invest in projects located in designated Ohio Opportunity Zones.
  - The Taxpayer is eligible for a nonrefundable tax credit equal to 10% of the total of its funds that were invested in the property.
  - A Taxpayer that holds an unclaimed Ohio Opportunity Zone Tax Credit Certificate may notify the Tax Commissioner in writing that the Taxpayer is transferring the right to claim the credit.

State Tax Credits

Other State Tax Credits

- The majority of states offer R&D credits against their state income and/or franchise tax liabilities.

- Some R&D credits are refundable, while others offer credits that can be carried forward.

- Ohio border states that offer a state-level R&D credit:
    - ***Yes*** – Indiana, Kentucky, and Pennsylvania
    - ***No*** – Michigan and West Virginia

- Other states that offer a R&D credit:
    - California, Florida, Massachusetts, and Texas

- Be certain to review each state's R&D credit rules.

State Tax Credits

Other State Tax Credits – cont'd

- Many states also offer an investment tax credit for investing in qualified property.

- Ohio border states that offer a state-level investment tax credit:
    - ***Yes*** – Indiana, Kentucky, and West Virginia
    - ***No*** – Michigan and Pennsylvania

- Other states that offer an investment tax credit:
    - California, Florida, Massachusetts, New York and Tennessee

- Note that some of the above credits are negotiated credits and not statutory. Need to review each state's rules for eligibility.

State Tax Credits

Other State Tax Credits – cont'd

- Many states also offer job creation tax credits for creating jobs in a state.

- Ohio border states that offer a state-level job creation tax credit:
  - ***Yes*** – Indiana, Kentucky, Pennsylvania, and West Virginia
  - ***No*** – Michigan

- Other states that offer a job creation tax credit:
  - Colorado, Florida, Massachusetts, New York and Tennessee

- Note that some of the above credits are negotiated credits and not statutory. Need to review each state's rules for eligibility.

State Tax Credits

Other State Tax Credits – cont'd

- North Carolina Employer Tax Credit - Under North Carolina's COVID-19 Recovery Act (S.L. 2020-3), employers will receive a tax credit towards their contribution to the state's Unemployment Insurance Fund.

- The credit is equal to the amount of the employer's contribution due to the fund for the first quarter of 2020.

- Employers do not need to do anything to receive this credit other than to file their Q1 2020 Tax and Wage Report. Employers must file the report to receive the credit.

- Any payments made for the first quarter will automatically be applied to any contributions due for the second quarter of 2020. If the amount of the credit is higher than the contributions due, the difference will be refunded.

Sales / Use Tax

Exemptions = Areas for potential overpayment

- Manufacturing
- Packaging
- Research & Development
- Software – Multiple points of use
- Temporary Employment
- Production of Printed Matter
- Food preparation
- Cleaning (in the food manufacturing context)
- Transportation for hire
- Advertising (must price and describe)
- Direct marketing
- Production of crude oil or natural gas

Sales / Use Tax

Identifying Potential Overpayments

- Identify large spending by vendor, account or purchase type
- Identify tax paid on these purchases
    - Tax paid to vendor
    - Use tax accrued
- Estimate overpayment for entire statute period
    - 4 years in Ohio
    - 3 to 4 years in other states
- Analyze cost benefit
    - Include potential interest amount in the analysis
    - Filing refund claim vs. changing prospectively

Sales / Use Tax

Refund Process – Ohio

- "Self help" Credits
  - Not allowed by the Ohio Department of Taxation

- Refund claim form and related documentation
  - File claim with Ohio Department of Taxation
  - Importance of a "turnkey" filing
  - Form ST AR - Application for Sales/Use Tax Refund
  - Spreadsheet detail in the designated format
  - Explanation of exempt use (reasoning for exemption)
  - All invoices included in refund
  - Proof of Payment – Ability to provide samples

Refund Process – Other States

- In general, similar to Ohio
- Documentation or process may differ slightly

Sales / Use Tax

Audit risk in filing a refund claim

- Not guaranteed an audit
- Taxpayer should understand exposure amounts prior to filing a claim
- Utilize VDA program or participatory audit, if exposure exists

What if my company is already under audit?

- Great time to look for overpayments
- ODT will not focus on this
- No offsets in audit for sales tax paid to vendor
- Use tax overpayments offset audit amount

Sales / Use Tax

Prospective strategies to reduce tax and pay the appropriate amount

- Exemption certificate insurance
    - Take advantage of exemptions
    - Issue certificates to all vendors selling exempt items
    - “Mixed use” vendors and how to handle
    - Beware of items purchased exempt, later used in taxable manner
- Changes to use tax process
    - Include vendor’s charging tax in monthly use tax process
    - Education of A/P team to spot possible issues (under/overpayments)
    - Direct payment permit as an option
    - Percentage reporting for expense accounts
    - Establish thresholds for review
    - Spend types and accounts not reviewed
    - Importance of continued diligence

Real Estate Valuation Appeals

Overview

- Because real estate values are ultimately determined by the taxing jurisdiction, taxpayers unsatisfied with their value have the right to appeal
- In order to be successful, taxpayer must provide support for their opinion of value, and could include:
    - Recent sale documentation
    - Appraisal
    - Comparable sales
    - Demonstration of error in jurisdiction's records
    - Proof of exemption
- Considerations
    - Possibility of tax increase
    - Current year of appraisal cycle
    - Cost-Benefit Analysis
    - Loan Covenants
- Many appeal processes are legal proceedings from the outset and may require representation

Real Estate Valuation Appeals

Common Triggers

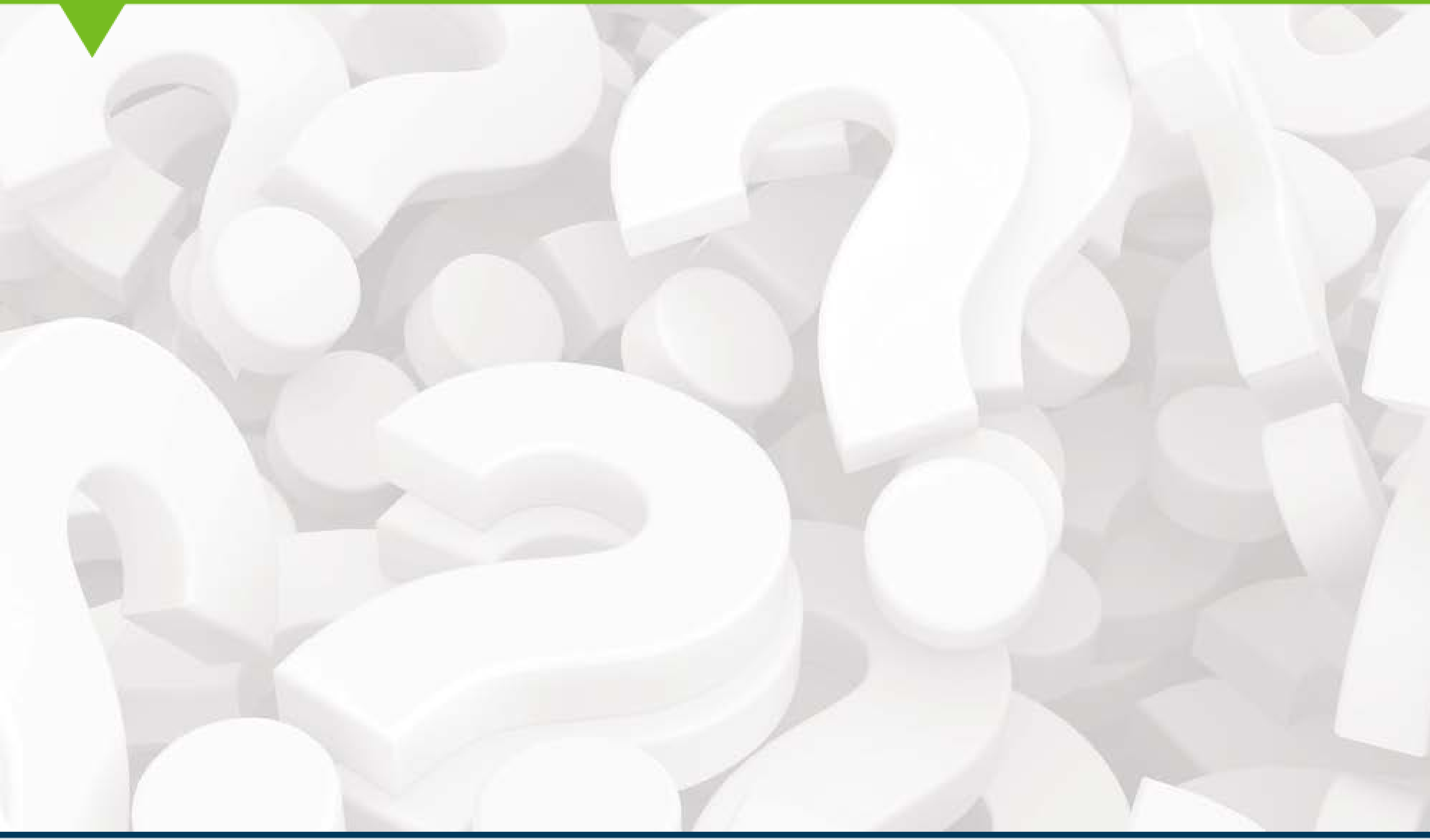
- Own/Lease property (-ies) with a combined value of at least $2.5 million
- Own/Lease property in multiple states
- Recent arm's-length purchase
- Building requires updates/significant amount of deferred maintenance
- Multiple building additions
- Property in first year of valuation cycle

Real Estate Valuation Appeals

Appeal Process

- Most states have a multi-level appeal process
- Informal appeals may be limited to specific time period
  - Ohio informal appeals only occur during revaluation years
  - Michigan and Kentucky have “open inspection” periods to discuss value with assessors before appeals begin
- Formal appeals often include sworn testimony, presentment of evidence, court motions and written arguments
- Supreme Court appeals are typically reserved for situations where precedent was ignored or law was misapplied
- Settlements are encouraged at higher appellate levels (especially in Ohio)

Questions?



Contact Information

Sara Goldhardt, CPA
Director,
State & Local Tax Services
(614) 947-5243
sgoldhardt@gbq.com

Jeff Monsman, JD
Senior Manager,
State & Local Tax Services
(614) 947-5226
jmonsman@gbq.com