


NAVIGATING AN ECONOMY IN TRANSITION


Sales, Use, and Transfer Tax Considerations

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Agenda

- Business Reorganization Transaction Issues
 - Overview & Key Principles
 - Mergers & Acquisitions
 - Exclusions/Exemptions
- Non-Reorganization Intercompany Transaction Issues
 - Structuring Issues
 - Captives/Shared Services
 - Intercompany Exemptions
- Question/Answer

Business Reorganization Issues

Corporate Reorganization - Overview

- Corporate reorganization transactions are generally structured based on the federal and state corporate income tax implications of the transactions
- Sales and use tax aspects of corporate reorganization transactions differ from federal and state income tax
- Exchange of tangible personal property (TPP) for consideration generally triggers the sales/use tax aspects
- Don't overlook exemptions/exclusions
- Don't overlook sales/use tax incentives

Key Thought and a Few Basics

Proper Planning of Business Reorganization
Can Reduce or Eliminate Potential
Sales/Use Tax Liability

General Rules for Sales/Use Taxes

- **Every** transfer of TPP is potentially subject to sales or use tax, unless a specific statutory exclusion or exemption applies
- State and local sales/use tax aspects of a business restructuring generally do not follow federal or state income tax treatment

General Sales/Use Tax Principles

- Is there a “sale” or other “transfer”?
 - “Sale” is generally defined very broadly
- Is there consideration for the “sale” or “transfer”?
 - “Consideration” may be broadly interpreted
 - Assumption of liabilities could create “consideration”
- Is the property transferred of a type that is subject to sales/use tax (e.g., TPP)?
- Are there any exclusions or exemptions that apply?

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Principles and Doctrines to Ponder

- Form-over-Substance
 - The “norm” in the sales tax world?
- Substance-over-Form
 - A judicially-created principle in the federal income tax world
- Step Transaction Doctrine
 - A corollary to the substance-over-form principle
- Which principle applies in the sales tax context?
- Does the step transaction doctrine apply in the sales tax context?

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First Question to Ask

What is the form of the transaction?

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Mergers & Acquisitions Model

	Asset	Stock
Nontaxable	Type A Type C Forward Triangular Merger Type D §351	Type B Reverse Triangular Merger §351
Taxable	Contractual Forward Cash Merger §1060 §338	Direct Stock Purchase Reverse Cash Merger §338

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**If you think the transaction is a taxable one,
what's your next step?**

Go mining for exclusions or exemptions!

Exclusions and Exemptions

- Vary from State to State
- General sales/use tax exclusions/exemptions
 - Example: isolated/occasional/casual sale exclusion/exemption
 - Manufacturing machinery and equipment exclusions/exemptions
 - Sale for resale exclusions/exemptions
- Specific Exclusions/Exemptions for Business Restructuring Transactions

Isolated or Occasional Sale Exemption/Exclusion

- Varies from State to State
 - Broad vs. narrow application
- Examples
 - Calif. Rev. and Tax Code §6006.5
 - S.C. Sales and Use Tax Regs. §117-322
 - WI Stat. §77.54(7)(a), Tax Rule §11.34(3)(b)
 - N.Y. Tax Law §1115(a)(18); N.Y. Regs. §528.19 (restrictive example)
 - IL – 35 ILCS 120/1(liberal example)

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Sale for Resale Exemption/Exclusion

- Available in All Sales/Use Tax Jurisdictions
- General Characteristics
 - Applicable to inventory-type property
 - Requires resale certificate from buyer
 - Potential administrative burdens with resale certificates

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Transaction-Specific Exclusions/Exemptions

- Transfers to New Corporations for Equity Interest
 - Examples: Missouri, Georgia, New York, New Jersey, Vermont, Maryland, Oklahoma and Texas
 - Be aware of possible temporal restrictions
 - See *Noar Trucking Co., Inc. v. State Tax Comm.*, 527 N.Y.S.2d 597 (App. Div. 3d Dept. 1988)
 - California
 - Blanket exemption for transfers of TPP to controlled transferee corporations that are newly-organized in start-up situations and a more limited exemption for later transfers

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Transaction-Specific Exclusions/Exemptions

- Statutory Mergers or Consolidations
 - Beware of specific statutory definitions of tax-free reorganizations in Internal Revenue Code vs. state and local sales/use tax statutes
 - CA, NY and Iowa have specific exemptions for statutory mergers/consolidations
 - Some states exempt from sales taxes any transactions that are tax-free for income tax purposes under any of the provisions of I.R.C. §368
 - e.g., Washington, Hawaii and Maryland

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Transaction Specific Exemptions

- Corporate Liquidations
 - Many states (e.g., NY, CA and OK) have exemptions for corporate liquidations
 - Some have exceptions for inventory
 - Other exemptions/exclusions might apply in other states
 - Is there consideration in a complete liquidation? (see Cal. Rev. and Tax. Code section 6006; Sales Tax Counsel Ruling 395.2280; Calif. Sales and Use Tax Reg. Sec. 1595(b)(5))

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Transaction Specific Exemptions

- Capital Contributions
 - Some states exempt, but not always clearly
 - Is there any “consideration” if no new stock is issued and no assumption of debt?

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Transfers of Excess Business Assets

- Most states do not provide an exemption for transfers between related parties. If business assets are transferred from one entity to another, consider the following:
 - Is the transfer taxable?
 - Consider exemptions, such as casual / isolated sale, manufacturing, resale, etc.
 - What is the tax base?
 - What is the consideration?
 - Can a credit be taken for taxes paid by the other entity?

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Other Considerations

- Entity Going Out of Existence
 - Out of Existence / Withdraw Affidavits
 - Final Returns
 - Record Retention for Future Audits
 - Particularly important if entity was on a different system than survivor
- Surviving Entity
 - Jurisdictions where returns are filed
 - Do you need to register in any new jurisdictions due to the restructuring?
 - Incentives, Enterprise Zone, etc.
 - Confirm they are transferable
 - File necessary applications, etc.

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Transfer Taxes

- Real Estate Transfers
 - Fee imposed on conveyance of interest in real property
- Possible Exemptions
 - Intercompany transfers or conveyances
 - Transfers pursuant to merger
 - Deeds by Subsidiary to its Parent in liquidations
 - Changes in identity without change in beneficial ownership
- Miscellaneous Transfer Taxes/Fees

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Non-Reorganization Intercompany Transaction Issues

Structuring Issues

- Many companies use special purpose entities, thus resulting in day-to-day intercompany transactions. Consider the following:
 - Procurement Companies
 - Leasing Companies
 - Transportation Companies

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Shared Service Centers / Corporate Procurements

- Centralized purchasing results in intercompany charges for centralized purchases, such as office supplies, software, etc. This can create complexity from a sales and use tax perspective:
 - Who is the purchaser and thus responsible for taxes?
 - How is the intercompany transaction described?
 - Is it invoiced?
 - Does it include a mark up?
 - Are there written agreements in place?

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Intercompany Exemptions

- Generally, sales between related entities are subject to sales tax unless an exemption exists
- Connecticut
 - Taxable services can be exempt if rendered between business entities and their 100%-owned subsidiaries
 - Exemption also applies between business entities controlled by the same entity

Intercompany Exemptions

- Texas
 - Exemption exists from tax for certain services when those services are provided to **affiliated entities**
 - Exemption is not allowed for services performed between a corporation and a **related "non-corporate" entity**
 - Limited Liability Company
 - Limited Liability Partnership

Intercompany Exemptions

- Tennessee
 - Exemption allowed from tax on services (which are otherwise taxable) between related entities
 - Does the exemption apply to non-corporate affiliates?
- Ohio
 - Exemption is between "two or more persons related in such a way that one person owns or controls the business operation of another."

Questions?

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