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

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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?

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

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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