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
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?

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?
First Question to Ask

What is the form of the transaction?

### Mergers & Acquisitions Model

<table>
<thead>
<tr>
<th></th>
<th>Asset</th>
<th>Stock</th>
</tr>
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<tbody>
<tr>
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<td>Type A</td>
<td>Type B</td>
</tr>
<tr>
<td></td>
<td>Type C</td>
<td>Reverse Triangular Merger</td>
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<td></td>
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<td>Contractual Forward Cash</td>
<td>Direct Stock Purchase</td>
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<td></td>
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<td>Reverse Cash Merger</td>
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<td></td>
<td>§338</td>
<td>§338</td>
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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)

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
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
  - 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

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
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))

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?
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?

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.
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

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

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?
**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
- **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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