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Sales and Use Tax Implications of M&A: Avoiding Costly Mistakes

Correctly Identifying Assets and Inherited Liabilities and Meeting Compliance Requirements

TUESDAY, NOVEMBER 19, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Partnership Distributions: Avoiding Tax Traps of Mixing Bowl Transactions, Disguised Sales, and 751(b)

Nov. 19, 2013

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Today's Program

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CHALLENGES RELATED TO MERGERS & ACQUISITIONS

Challenges Related to Mergers & Acquisitions

- Acquisition of Ownership Interests

Ownership interests may include stock of a C corporation, S corporation or a partnership interest. Each of these types of acquisitions will likely include all unrecorded liabilities of the target.

Therefore, a buyer may want to perform more due diligence review for this type of acquisition

Challenges Related to Mergers & Acquisitions

- Acquisitions of Assets

Tangible, intangible and real estate may represent the types of assets that may be purchased directly. The buyer may be potentially liable for unpaid sale sand use tax liability for the seller, up to the purchase price of the assets in most states.

Myron Vansickel, Experis

RISK MANAGEMENT OPPORTUNITIES

Risk Management

- Asset Purchases

Here you may become liable up to the purchase price for the seller’s tax obligation if you do not protect yourself by filing “bulk sales” notifications in the states where assets are located.

Generally, this relieves the purchaser form the assertions of successor’s liability for most states and the requirements for notification will vary form state to state.

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Managing Sales Tax on Acquisitive Transactions

- Identification of Non-Taxable & Exempt Items

Cash, marketable securities, real estate and other intangibles are not subject to sales tax. The sales tax is applied to the tangible personal property based on the sales price allocated to this property.

There may be sales tax exemptions on various property on a state by state basis, e.g., manufacturing equipment.

Managing Sales Tax on Acquisitive Transactions

- Allocation of Purchase Price

The allocation of purchase price is very important in determining the sales price for the tangible personal property purchased. Valuations may need to be performed to determine the Fair Market Value of the assets purchased.

Book value may not be indicative of the true FMV! Book value is based on useful life and depreciation methods that may not reflect the true value of assets if sold between a willing buyer and seller.

Managing Sales Tax on Acquisitive Transactions

- Allocation of Purchase Price Methodology

IRC Reg. § 1.338-6 and Reg. § 1.338.7 provide the residual methodology for allocating purchase price. The Regulations provide seven classes of property.

- Class I: Cash and cash equivalent;.
- Class II: Actively traded personal property as certificates of deposit and foreign currency;

Managing Sales Tax on Acquisitive Transactions

- Allocation of Purchas Price Continued

Class III: Accounts Receivable, mortgages, and credit card receivables arising from the ordinary course of business.

Class IV: Stock in Trade (inventory)

Class V: All assets not in Classes I, II, III and IV. (furniture and fixtures; equipment)

Managing Sales Tax on Acquisitive Transactions

- Allocation of Purchase Price Continued

Class VI: All IRC Code Sec. 197 intangibles, except good will and going concern value.

Class VII: Goodwill and going concern

Goodwill is not valued separate, but is the remainder of the purchase price after other class has been identified and valued.

Transactions Structuring Using Entities

- **Asset Purchase**: An acquisition of all of most of the assets and liabilities of a company or a line of business. Generally, do not inherit tax liabilities except for sales taxes under successor liability rules. Remember that the states are going to look at the Fair Market Value of the assets purchased in computing sales tax due.

Transactions Structuring Using Entities

- **Stock Purchase:** A business transfer where either the corporation stock or partnership ownership interest is transferred.

The sales tax treatment of a merger or acquisition generally depends on its form. State sales and use tax apply only to transfers of the tangible personal property, so transfers of corporate stock and securities are not subject to sales tax.

Transactions Structuring Using Entities

Structure of the Deal – Sales/Use Tax

- A Reorganizations: Many states provide specific exemptions for transfers pursuant to a statutory merger or consolidation
- B Reorganizations: Stock-for-stock reorganizations should not have any sales or use tax implications, since the property transferred is intangible property
- C Reorganizations: An acquisition of corporate assets for stock requires careful examination since the corporation is acquiring tangible property, unless some exemption applies

Transactions Structuring Using Entities

- D Reorganizations: Typically involve transfers of property to a corporation, for stock in that corporation. The property transfer is potentially subject to sales tax, however many states have exemptions for transfers to newly-formed corporations in exchange for stock
- Recapitalization on E: Does not trigger sales or use taxes since recapitalization involved transfers of intangibles.
- F Reorganizations: Transactions that are a “mere change in identity, form or place of organization” generally are not subject to sales tax.

Transactions Structuring Using Entities

- Triangular Mergers: The federal income tax rules provide tax-free reorganization treatment, however depending on the transaction
  - Forward triangular merger – typically subject to sales tax unless a specific exemption exists
  - Reverse triangular merger – no sales tax on the target's assets

Transactions Structuring Using Entities

Different tax outcomes by two different states regarding tax-free reorganizations subject to sales tax.

- New York exempts the transfer of property to a corporation in a statutory merger or consolidation, but only if the transfer is in exchange for the acquiring corporation's stock. N.Y. Regs. § 526.6(d)(7)
- Maryland apparently exemption applies to transfers in exchange for stock of the parent of the acquiring corporation as well as to transfers in exchange for stock of the acquiring corporation itself. MD. Code Ann. Tax-Gen. 11-209(c)(1)(i)

Transactions Structuring Using Entities

- The New York exemption may apply when the parent corporation can form a new subsidiary and merge it into the target with the target surviving the merger and the target shareholders receiving parent stock in the transaction.
- Where the merger of the target into the parent's subsidiary which the subsidiary survives and the target corporation receives stock of the parent is not exempt from New York Sales tax.

Transactions Structuring Using Entities

- Maryland takes a broader approach and their exemption for all transfers of property in transactions that qualify as tax free reorganizations under IRC § 368. (see prior citation)

Occasional Sale Exemption

“

Occasional or casual sale” refers to an isolated transaction is which tangible personal property or taxable services is sold other than in the ordinary course of repeated and successive transactions. Otherwise not a “retail” sale.

Some states provide an exemption for “occasional or casual sales” that my be applicable to asset transactions when all of most of a biusness assets are purchased.

Liability of Purchaser for Seller's Tax Obligations

"Bulk sale" notification. Some states will require written notification within 10 days prior to a sale of business assets and/or the buyer must withhold taxes owed by the seller until the seller can clear its tax obligations.

The asset sale that may qualify for this is one where the entire assets of the business are sold or a substantial portion of a business line.

Liability of Purchaser for Seller’s Tax Obligations

It is imperative to do your due diligence when acquiring a business and especially when it come to sales and use tax. It can add cost to the acquisition that was not anticipated.

Many buyers will ask for “tax clearance” certificates to be delivered a the time of closing to prove that the seller has paid all taxes due at that time.

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RISK MANAGEMENT OPPORTUNITIES: NEXUS AND COMPLIANCE CHALLENGES

Nexus

A. New Filing Obligations Resulting from Acquisition

B. Impact on Current Nexus Positions

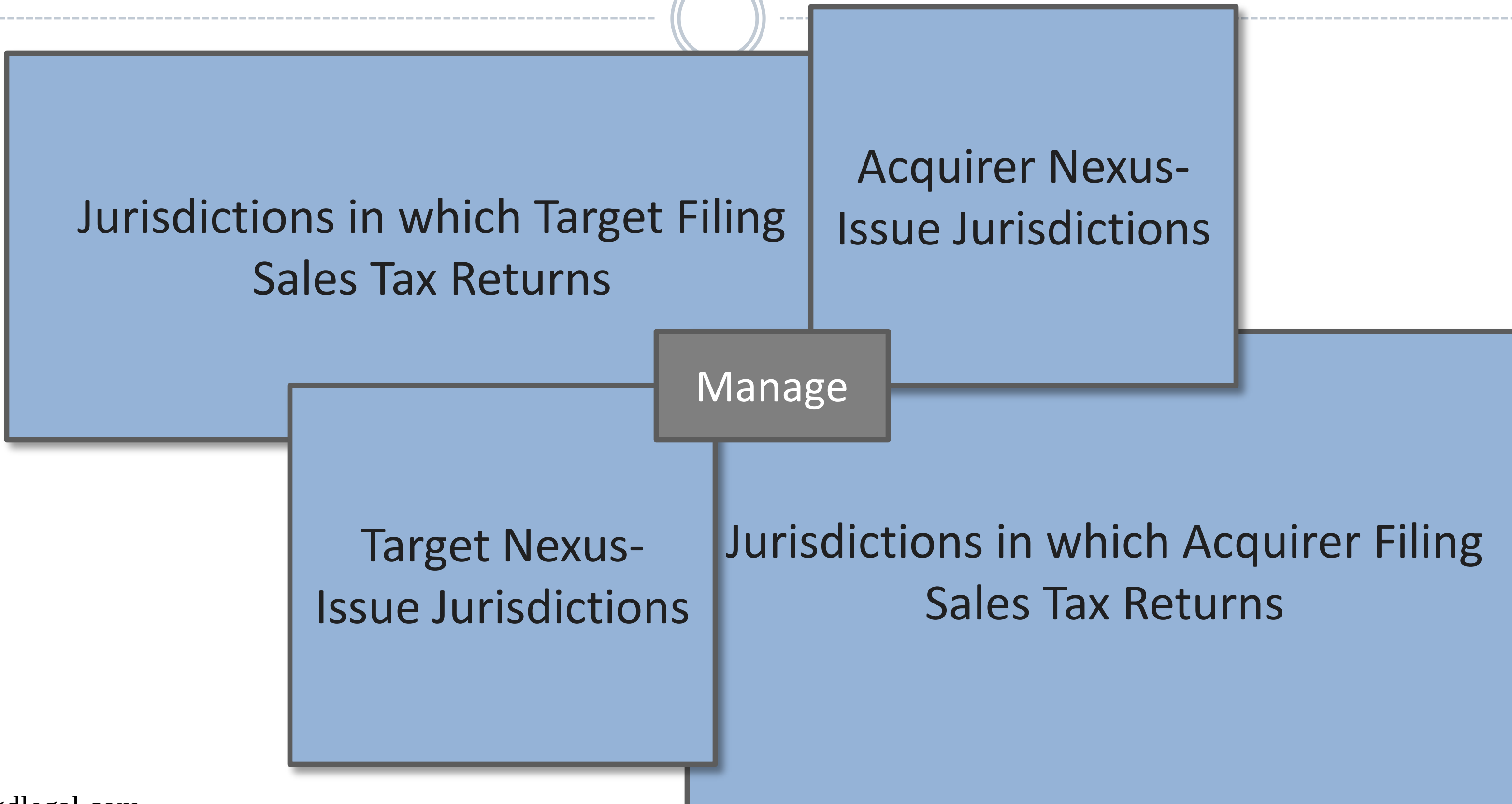
C. Opportunities for Resolution (VDA, etc.)

Nexus: New Filing Obligations Resulting from Acquisition

- Physical Locations of Target Company
  - Headquarters
  - Manufacturing Facilities
  - Distribution Facilities
  - Sales Offices
  - Retail Locations
- Presence of Target's Employees
- Target's Economic Activities

Nexus: New Filing Obligations Resulting from Acquisition

Nexus: Impact on Current Nexus Positions



Nexus: Opportunities for Mitigation or Resolution (VDA, etc.)

- Amnesty
- Voluntary Disclosure Agreements
- "Opportunity" to Begin Filing
- Other Strategies
  - Not Acquire Aspect of Target?
  - Other Structural Opportunities?

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Compliance Challenges

- Nexus – Filing Obligations
- Tax Base Determinations
  - Application of Exemptions
  - Audit Experience
- Resale & Exemption Certificates (Survivor of M&A Transaction?)
- Audits: Prior; Ongoing; Future

DUE DILIGENCE BEST PRACTICES

Documents to Obtain and Review

- Licenses
- Tax Calendar
- Tax Returns
- Tax Return Work Papers & Related Documents
- G/L Accounts
- Resale & Exemption Certificates
- Sales & Use Tax Handbook(s)
- Planning Memoranda
- Prior Audits
- Other Relevant Documents

Anticipate Post-Acquisition Issues

- Nexus Positions
  - Sales Tax “Footprint”
  - Tax Filings
- Tax Base Positions: Exemptions, Credits, Etc.
- Documentation & Substantiation Issues
- Prior Audit Effect on Current Audits
- Financial Statement Impact