Tax Issues for Manufacturers and Distributors: CARES Act, Sales Tax Compliance, Capital Expenses, Equipment, Credits

TUESDAY, SEPTEMBER 29, 2020, 1:00-2:50 pm Eastern

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September 29, 2020

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Agenda

- Recent Federal Legislation Providing Tax Breaks
- State Sales Tax Challenges
- State Income Tax Challenges
- Best Practices

Recent Federal Legislation Providing Tax Breaks

- CARES Act
- R&D Tax Credit
- Work Opportunity Tax Credit
- Other Incentives

CARES Act

- *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act)
  - Signed into law on March 27, 2020
  - Provided relief to businesses and individuals impacted by COVID-19
  - Several key federal income tax provisions were included within the legislation

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CARES Act

- Key Federal Income Tax Provisions
  - Federal NOL Carrybacks and Carryforwards
  - Business Interest Deduction (IRC Section 163(j))
  - Qualified Improvement Property
  - Paycheck Protection Program
  - Federal Employee Retention Credit
  - Federal Employer Payroll Tax Deferral

CARES Act

- Federal NOL Carrybacks and Carryforwards
  - The CARES Act allows a five-year carryback of any NOL generated in a taxable year beginning after December 31, 2017, and before January 1, 2021
  - The Tax Cuts and Jobs Act of 2017 lifted the previous 20-year limit on NOL carryforwards, but limited NOLs to 80% of taxable income in any one tax period. The CARES Act temporarily removes this 80% limit for taxable years beginning before 2021 to allow an NOL carryforward to fully offsets income

CARES Act

- Key Federal Income Tax Provisions
  - Business Interest Expense Deduction - IRC Section 163(j)
    - The CARES Act increases the 30% limitation to 50% of the taxpayer's adjusted taxable income for taxpayers other than partnerships
    - For partnerships the limitation is applied at the entity level, not the partner level
    - The CARES Act also introduced two new elections:
      - An election to not apply the increased 50% limitation in taxable year beginning 2019 or 2020.
      - An election to use 2019 ATI instead of 2020 ATI for the computation of the 2020 interest expense limitation.

CARES Act

- Qualified Improvement Property
    - CARES Act fixed TCJA retail glitch – qualified improvement property (QIP) is now considered 15-year property & eligible for bonus depreciation
    - QIP includes improvements made to an interior portion of nonresidential real property (but does not include improvements to internal structural framework, enlargements of the building & elevators/escalators)

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CARES Act

- Paycheck Protection Program
  - Federally backed loans to help small businesses continue making payroll, rent, mortgage, and utility payments, among others, during the crisis
  - Loan forgiveness is available to qualifying loan recipients that retain their employees and sufficiently avoid pay cuts during the pandemic
  - Pursuant to the CARES Act, paycheck protection program loans are excluded from taxable income and will not be subject to income taxes at the federal level

CARES Act

- Federal Employee Retention Credit
  - Temporary refundable credit for employers subject to full or partial business suspension due to the COVID-19 emergency or for employers whose gross receipts have significantly declined due to COVID-19
  - Credit is equal to 50% of qualifying wages paid after March 12, 2020 and before January 1, 2021, not to exceed $10,000 in total per employee for all calendar quarters
  - The maximum credit for any one employee is $5,000

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CARES Act

- Federal Employer Payroll Tax Deferral
  - CARES Act allows taxpayers to defer the employer's portion of Social Security tax incurred during the period beginning on March 27, 2020, & ending December 31, 2020
  - Any 2020 deferred payroll tax amounts would be due to the government in two installments:
    - One-half at the end of 2021
    - The remaining one-half at the end of 2022
  - Not available for taxpayers that had PPP loans forgiven

R&D Tax Credit

- Federal tax credit based on a company's increase in spending on research & development with qualified expenditures
- Estimated value of the federal R&D credit is 4.5% to 6.5% of qualified research expenses

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R&D Tax Credit

- Qualified research expenses
  - Wages
    - Direct research, direct support & direct supervision
    - 80 percent or more rule
  - Supplies
    - Raw materials used for prototypes or for testing
  - Contract research
    - Third-party expenses
    - 65 percent limitation

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R&D Tax Credit

- Consider impact of COVID-19
  - Remote employees
  - Companies with PPP loans
- State research credits also available

Work Opportunity Tax Credit

- Federal tax credit available to employers who hire & retain individuals from IRS designated target groups
- Established in 1996 as a Federal tax credit program, with the goal to assist targeted workers
- Tax credit allows employers to reduce their federal tax liability for each qualifying new hire

Work Opportunity Tax Credit

- Qualifying Designated Groups
  - Short-term or Long-term Temporary Assistance for Needy Families (TANF) recipient
  - Food Stamp recipient
  - Qualified long-term unemployment recipient
  - Supplemental Security income recipient
  - Qualified ex-felon
  - Vocational Rehabilitation referral
  - Qualified summer youth
  - Designated community resident

Work Opportunity Tax Credit

- Qualifying Designated Groups (cont.)
  - Qualified veteran
  - Disabled veteran
  - Unemployed disabled veteran
  - Unemployed veteran – Four weeks
  - Unemployed veteran – Six months

Work Opportunity Tax Credit

- Designated Community Resident
  - An 18–39 year old who lives within one of the federally-designated Rural Renewal Counties or Empowerment Zones
  - Rural renewal county is defined as a county in a rural area that lost population during the five-year periods 1990–1994 & 1995–1999

Other Incentives

- Indian Tax Credit
- State specific credits for new jobs created

State Sales Tax Challenges for Manufacturers and Distributors

- Recent state legislation
- Sales tax implications of selling to retailers and directly to consumers
- Other key issues
- Taxation of manufacturing equipment
- Sales tax exemptions

Recent State Legislation

Arkansas

- In 2019, Arkansas expanded the refund for sales and use taxes related to the repair or partial replacement of certain machinery and equipment to include machinery and equipment purchased to modify, replace, or repair, existing molds and dies used directly in production, manufacturing, or assembling at a manufacturing plant or facility in Arkansas.

Recent State Legislation

California

- Effective January 1, 2020 California extended its green manufacturing and advanced manufacturing exclusion to January 1, 2026.
- Effective September 2019, California extended its sales tax exemption for new, used, or remanufactured trailers or semitrailers to also include new, used, or remanufactured trucks purchased for use in interstate commerce or outside of California.

San Francisco Gross-Receipts

- On September 9, 2020, the California Supreme Court declines to review the California Court of Appeals decision, upholding the gross-receipts tax to fund homelessness services. Further, San Francisco is proposing two additional propositions that will appear on the November 2020 ballot to reform the city's business tax.

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Recent State Legislation

Illinois

- Effective July 2019, Illinois expanded the state's manufacturing sales and use tax exemption to include production related tangible personal property and expanded the definition to include consumables used in the manufacturing process. The exemption now covers items previously covered in under the Manufacturer's Purchase Credit.

Iowa

- Iowa enacted an amendment to Iowa Administrative Code 230.15(4), to clarify the limitations on qualifying for the state's manufacturing sales tax exemption. A person is not eligible for a manufacturing exemption is that person is "primarily engaged" in construction contracting, repairing tangible personal property or real property, providing health care, farming, and transporting to hire.

Recent State Legislation

Missouri

- Senate Bill 87 extends the statute of limitations from three years to ten years These changes went into effect on August 28, 2019.
- The bill did not change the statute of limitations for audits (i.e., remaining as three years).

New Jersey

- Effective on January 21, 2020, New Jersey enacted an exemption for purchases of energy by recovered materials manufacturing facilities. While the energy sellers will continue to charge sales tax, the facility may apply for a refund of sales tax paid.

Sales Tax Implications of Selling to Retailers and Directly to Consumers

Wayfair - What States are doing

- Remote Seller
- Physical presence no longer required as of June 21, 2018
- Economic nexus
  - Generally – $100,000 gross receipts and/or 200 transactions
  - Florida and Missouri are the only states that have not implemented economic nexus
  - Alaska – local jurisdictions have enacted economic nexus
- Local jurisdictions

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Sales Tax Implications of Selling to Retailers and Directly to Consumers

Marketplace Facilitator

- Definition - Engaging in any of the following:
  - Transmitting or otherwise communicating the offer or acceptance between buyer and seller
  - Owning or operating the infrastructure, electronic, physical, or technology that brings the buyers and sellers together.
  - Providing a virtual currency that buyers are allowed or required to use to purchase products from the seller.

Sales Tax Implications of Selling to Retailers and Directly to Consumers

Marketplace Facilitator

- Engaging in any of the following activities with respect to the marketplace seller's products :
  - Payment processing services
  - Fulfillment or storage services
  - Listing products for sale
  - Setting prices
  - Branding sales as those of the MPF
  - Order taking
  - Providing customer service or accepting or assisting with returns or exchanges

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Sales Tax Implications of Selling to Retailers and Directly to Consumers

Marketplace Facilitator

- Responsibilities
  - 41 states require Marketplace Facilitator to collect tax
    - Some state require Marketplace Facilitator to remit to on behalf of the Marketplace Seller
      - Seller may still have a reporting requirement
  - Florida, Kansas & Missouri do not require Marketplace Facilitator to collect tax
  - FBA Amazon

Sales Tax Implications of Selling to Retailers and Directly to Consumers

Marketplace Facilitator

- Illinois
  - Marketplace facilitator obligation applies only to sales that are subject to use tax in Illinois.
    - Use tax applies when they are made from inventory located outside of the state.
  - Illinois requires **marketplace sellers** to collect tax on all marketplace sales that are subject to retailers' occupation tax in Illinois.
    - Retailers’ Occupation Tax (ROT) when they are made from inventory located inside of Illinois.

Sales Tax Implications of Selling to Retailers and Directly to Consumers

- Marketplace Seller
  - Set-up products correctly
    - Liability can shift if seller does not provide accurate information.
  - Register for sales and use tax in states where they have nexus
  - Remit sales and use tax in states where the MPF is not required to collect tax
  - Liability
  - Taxes other than sales and use tax
    - Chicago – lease tax applies to software and some digital products
    - Accommodation taxes
    - Soda taxes, amusement taxes

Other Key Issues – Wayfair Impact on Functional Business Areas

	Tax	Accounting	AR	AP	Legal	IT	Treasury	Purchasing	Internal Audit
Purchases Side – Accrual Process				X					
Tracking Sales	X	X							
Process to Collect Tax	X		X			X			
Maintain Certificates			X	X					
Accounting – Separate GL; AAI Coding		X				X			
Remit/Register	X			X	X		X		
Internal Controls/Processes									X
Issue PO								X	

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Other Key Issues - Nexus

Nexus can still be created by:

- In-state employees (including employees working remotely from home)
- In-state property
- Sporadic employee visits
- Independent contractors in the state acting on taxpayer's behalf
- Attending trade shows
- Making deliveries in company vehicles
- Click-through nexus

Other Key Issues - Registration

General registration pitfalls

- Identifying the appropriate states in which to register
- Knowing which state to avoid registration and why
- Impact to obtaining customer sales when there is an absence of a registration
- Thinking that economic nexus thresholds for sales tax only apply to online sellers like Amazon or Wayfair

Other Key Issues - Registration

Pitfalls during registration

- Responsible party requirements
- Personal information disclosures for officers or others
- Importance of NAICS code – may impact exemption eligibility and could influence what content the state communicates to the business
- Completing all required sections as well as satisfying other forms that must be submitted along with or in conjunction with sales tax registrations.

Other Key Issues - Registration

Start Dates

- Measurement Period
  - Periods to measure thresholds may differ
    - Most say “current or preceding calendar year”
    - Others
      - Preceding 12 months
      - Previous calendar year
      - Current calendar year
      - Past12 months on July 1
      - Determined on a quarterly basis for previous 12 months
      - Some simply say “annual sales”

Registration Thresholds

- Revenue
  - Gross Revenue, including or excluding wholesales/resales
- Transactions

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Other Key Issues - Registration

Registration Best Practices

- Determining when registration is necessary
  - Look-back period may extend beyond the current period. Consider implications to signing a registration form under penalties of perjury if registration is only done prospectively.
  - Consider how trailing nexus impacts the time period that a registration will remain active.
  - When activity ceases or diminishes in a state, consider how to un-register

What to register for

- What other registrations should be considered?
- Other tax types may be impacted including but not limited to income, franchise, gross receipts, and use tax.
- As part of tax registration, a license to do business in the respective state may be required to be obtained from the Secretary of State

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Other Key Issues - Exemption Certificates

Registration Best Practices

- Determining when registration is necessary
  - Look-back period may extend beyond the current period. Consider implications to signing a registration form under penalties of perjury if registration is only done prospectively.
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Other Key Issues - Compliance

- Proactive vs. Reactive Approach:
  - Proactive approach leads to a better use of working capital and protects against future audits and assessments
- Review economic nexus thresholds
  - Do wholesale, resale, or non-taxable services count towards threshold?
- Monitor state legislation
  - Louisiana – Economic nexus effective no later than 7/1/2020
- Technology/Automated Processes
  - Properly configured accounting software
  - Sales tax engine
  - Exemption certificate management
  - Direct pay permits
  - Use tax accrual

Taxation of Manufacturing Equipment

Most states have some exemptions

- No exemptions – Hawaii and South Dakota
- Reduced sales tax rate – Mississippi

Who qualifies

- Definition of manufacturing
  - Traditional
  - Restaurant

Taxation of Manufacturing Equipment

Where does exemption start and end

- Beginning – Removal of raw materials or first action
- During – Movement of WIP
- End – Final assembly or include final packaging

How wide is the exemption

- Linear – only actual production equipment
- Broad – production equipment, plus support equipment
  - Boiler, chiller, piping, electrical

What is exempt

- Equipment, consumables, packaging

Sales Tax Exemptions – Exemption vs Exclusion

Exemption – transaction is subject to tax. Exempt status must be documented

Exclusion – transaction is not subject because of statutory application

- Imposition statute
- Definitions

Sales Tax Exemptions

Types

- Product based – What is being purchased
  - May not require exemption certificate
    - Grocery items, prescriptions
- Use based – How the purchase will be used
  - Raw materials, purchase for resale/lease, manufacturing
- Buyer based – Who is making the purchase
  - Federal, state/local government, not-for-profit

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State Income Tax Challenges for Manufacturers and Distributors

- Increased nexus rules
  - Economic/factor nexus
  - Affiliate/attributional nexus
- Internal Revenue Code conformity
- Apportionment
- Gross receipts taxes
- State legislation and audit activity
  - NOL suspensions or limitations
  - Credit utilization
  - Nexus questionnaires

Increased Nexus Rules

- Economic/Factor Nexus
  - State attempt to transition away from physical presence nexus standard
  - Taxpayer is presumed to have nexus with a state if the business has a property, payroll or sales factor apportionment numerator that exceeds a certain threshold
  - Property: $50,000 or 25% of total
  - Payroll: $50,000 or 25% of total
  - Sales: $500,000 or 25% of total
  - Public Law 86-272 will apply but only for sellers of tangible personal property
  - Be wary of impact on pass-through entities

Increased Nexus Rules

- Economic/Factor Nexus

State	Sales Threshold
Alabama	$500,000 or 25% of total
California	$583,867 or 25% of total
Colorado	$500,000 or 25% of total
Connecticut	$500,000
Michigan	$350,000
New York	$1,000,000
Tennessee	$500,000 or 25% of total

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Increased Nexus Rules

- Economic/Factor Nexus
  - Massachusetts
    - Effective October 18, 2019
    - Update to 830 CMR 63.39.1 creates presumption that an out of state corporation with annual sales in Massachusetts of $500,000 or more is subject to corporate excise tax
    - Department of Revenue will aggregate related companies sales to reach the $500,000 threshold
    - Public Law 86-272 applies

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Increased Nexus Rules

- Economic/Factor Nexus
  - Pennsylvania
    - Effective January 1, 2020
    - Pennsylvania DOR issued a corporate income tax bulletin adopting new nexus requirements for purposes of Pennsylvania corporate net income tax in light of the decision in *Wayfair v. South Dakota* (Pennsylvania Corporation Tax Bulletin No. 2019-04, 09/30/2019)
    - Annual threshold is $500,000 of Pennsylvania sales
    - Public Law 86-272 applies

Increased Nexus Rules

- Economic/Factor Nexus
  - Philadelphia
    - Effective January 1, 2019
    - Amended Business Income & Receipts Tax (BIRT) Reg. §103 In response to *Wayfair*
    - Modifies Philadelphia's "doing business" provisions for BIRT purposes to establish economic nexus standard with a $100,000 sales threshold
    - Public Law 86-272 applies to only net income component of tax

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Increased Nexus Rules

- Economic/Factor Nexus
  - Texas
    - Comptroller passes amendment to franchise "margin" tax nexus rule that would adopts an economic nexus threshold of $500,000 in annual Texas receipts for taxable entities that do not have a physical presence in the state
    - Amendment applies to franchise tax reports due on or after Jan. 1, 2020.
    - Public Law 86-272 does not apply

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Increased Nexus Rules

- Affiliate/attributional nexus
  - Attributing nexus from a taxpayer's affiliated entities or other affiliates if there is an overlap of selling or other shared activities
  - Out-of-state seller is owned by or holds a substantial interest in an in-state seller, & out-of-state seller sells same or similar products under same or similar name
  - In-state taxpayer advertises, promotes or solicits sales
  - In-state taxpayer performs other services assisting or on behalf of out-of-state seller
  - Activities of one company may create nexus for other related entities

Internal Revenue Code Conformity

- State income tax treatment of federal income tax provisions will not have uniform impact across all states due to varying conformity to the Internal Revenue Code ("IRC")
- State conformity to the IRC has three major categories
  - Rolling (ex. - Kansas)
  - Static/Fixed-Date (ex. - Wisconsin)
  - Selective (ex. - Arkansas)

Apportionment

- Increased weighting of sales factor
- Consider impact of *Joyce* vs. *Finnigan* for states that require consolidated returns
- Determine applicability of special apportionment elections and provisions for manufacturers
- Review state guidance surrounding sales factor throwback rules

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Gross Receipts Taxes

- States that have entity level taxes on gross receipts or margin based entities include the following
  - Nevada Commerce Tax
  - Ohio Commercial Activity Tax
  - Oregon Corporate Activity Tax (effective 2020)
  - Tennessee Business Tax
  - Washington Business & Occupation Tax
- Pass-through & disregarded entities are taxpayers
- Factor nexus standards in play here & Public Law 86-272 protection won't apply

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State Legislation and Audit Activity

- NOL suspensions and limitations
  - For tax years beginning on or after January 1, 2020, and before January 1, 2023, California AB 85 suspends the usage of NOLs for California corporate taxpayers with at least $1 million of income subject to tax, and individual taxpayers with at least $1 million in net business income or modified adjusted gross income
  - California's 20-year NOL carryforward period will be extended by up to three years for losses that are not utilized due to the suspension

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State Legislation and Audit Activity

- Other Areas to Watch Going Forward
  - Impact of Future Stimulus Packages (HEALS Act)
  - Additional State NOL Suspensions
  - Gross Receipts Taxes
  - Property Tax
  - Future Decoupling on Income Items (ex. – GILTI)
  - Employee Retention Incentives and Credits
  - Enhanced Nexus Enforcement and Aggressive Audit Positions
  - Unclaimed Property

Best Practices

- Keep tabs of federal and state tax legislation
- Be proactive with responses to state tax inquiries
- Maintain quality tax files even when tax compliance functions are outsourced
- Continued review for refund opportunities
- Proper credits & incentives analysis prior to investment and hiring

Thank You!

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