State Tax Planning 101

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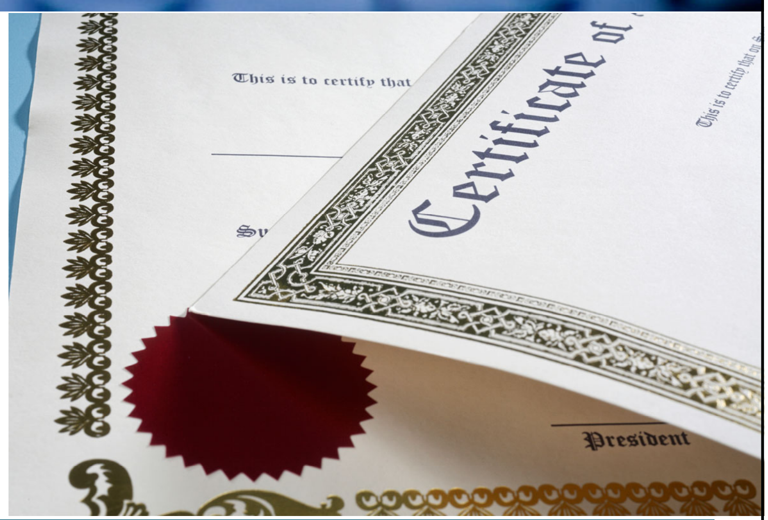
Housekeeping

- 4 attendance polls
- CPE credit, no CE Credit for EAs (sorry)
- Look for the link to claim your certificate



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Can state tax planning eliminate all taxes?

- Get this out of the way with your clients early
- Occasionally good state tax planning can result in little or no state tax on a business or transaction
- More often than not, the facts surrounding a business or transaction dictate the tax results and planning cannot totally eliminate state tax, but if done early, can help reduce tax
- Business / personal / transaction needs usually come first, tax benefits are a secondary consideration

Timing is everything

- Before addressing planning ideas, you must tell clients that timing is everything
- The more time we have to plan the better the results
- Countless clients have called me days before a transaction, or sometimes months after a transaction, even in a new tax year, looking for planning ideas to reduce tax burden…
- While sometimes just a close review of the applicable law can reduce taxes (or sometimes more is owed than previously thought…) often it is too late after the fact

Where does the business have some presence

- Any state tax planning must first begin by determining where a person or business has some presence
- Some of the following should be considered
  - Where owners / employees spend time and/or work from
  - Where there are customers
  - Where the business as property, real, personal and intangible
  - If a business is being sold, where is the buyer

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There are many types of state taxes

- Once you know where a business has some presence, then look at the taxes that may impact the business there
- Examples include:
  - Business income taxes
  - Sales taxes
  - Income taxes on owners of the business
  - Franchise taxes
  - Real and personal property taxes
  - Abandoned and unclaimed property (not strictly a tax, but can impact transactions)
  - Withholding tax
  - Not all of these will impact every business, person, or transaction, but you should be aware of those that may be relevant to the matter you are dealing with

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Nexus

- Generally nexus is the minimum number of contacts with a state a person or business must have to become subject to the state's laws / courts / taxes / etc.
- Often tax statutes and regulations dictate the nexus threshold applicable to that tax
- Often physical presence, sales amounts, and/or the number of transactions undertaken are the definition characteristics used by nexus standards
- All state nexus standards are limited by Federal law such as P.L. 86-272 and the constitution

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Now you can look for planning opportunities

- Once you know what state are "in play", what state taxes may impact a given matter, and if the person or business has nexus with the state then you can consider:
  - What the tax cost is
  - If planning can be done to reduce the tax cost without hurting the underlying person / business
  - For example, if a business has to pay significant state tax in state B because the business' largest customer is in state B and therefore the business must be there too, there may not be much planning that can be done
  - On the other hands, if say the business is a C corporation subject to 3 factor apportion (more on this later) but LLCs are subject to single sales factor apportionment, perhaps a relatively simple restructuring can significantly reduce income tax liability in a given state
  - Until you understand all the pieces impacting a matter you cannot plan for the best tax outcome

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Specific Areas to Consider

Income Taxes

- When dealing with a matter contained within a C-Corporation it generally does not matter where the company's shareholders are located
- When selling the stock of a C-Corporation where the company's shareholders is relevant
- When dealing with pass-through entities (e.g., S-Corp, partnership) and disregarded entities (e.g., SMLLCs) or sole-proprietors the location of the business AND the location of its owners can matter

What can be done to reduce state income tax burden? Sale of a Business

- If the income tax burden will fall on owners due to a sale, owners can consider moving to a lower tax jurisdiction before the transaction closed
- Check sourcing rules to make sure they do not require the gain to still be sourced to where business was located
  - Note that this is a developing area of law, question being if states can constitutionally source gains to location of business that were traditionally sourced to owner's place of domicile

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What can be done to reduce state income tax burden? Ongoing business

- Ultimately, business is conducted where customers are and where profits can be made. While places like New York, and California have relatively high tax rates, it is usually better to do business in these places to gain access to customers there.
- With that said, avoid places that may not have great business base and punish local businesses
- Traditionally income is sources using three factor apportionment
  - Sales factors
  - Payroll Factor
  - Property Factor
- The last two factors discourage businesses from locating in those jurisdictions. Most states have moves to single sales factor apportionment and it often makes sense to locate a business in such a jurisdiction given a choice
- Maximize credits and incentives

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What can be done to reduce state income tax burden? Other thoughts

- For now at least, P.L. 86-272 lives, mostly, though it is constantly under attack
- So long as taxpayers stay within the bounds of P.L. 86-272 and a particular state isn't actively attacking it, still a good planning tool
- Don't forget apportionment quirks:
  - Differences between pass-through entities and C-Corps
  - Differences between state specific language and UDITPA
  - Throwback and throw out rules, know them, and when possible use them to a taxpayer's advantage

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Sales Tax

- Post Wayfair many states have adopted economic nexus thresholds
- While taxpayers must collect and pay over sales tax based on physical or economic presence (assuming a state's economic nexus standard is permissible under Wayfair) smaller taxpayers may take advantage of not having nexus in states
- Similarly take advantage of state incentives and, when possible, operate in states that do not tax "business inputs"

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Planning Opportunities for Other State Taxes

- Operate in areas with special property tax benefits applicable to taxpayer's industries
- Many areas have considerable benefits for locating a business in said areas
- Consider future tax burdens if the intention it to develop and sell a business, e.g,, transfer taxes on real estate
- Compare a taxpayers "pressure points" (e.g., large personal property costs, large capital reserves, etc.) and compare how different states raise revenue when determining where to locate a business. I.e., if a state relies heavily on a capital base tax, companies with significant capital reserves may not wish to domicile there.

Know what the legislature is doing

- You can't keep track of every change in all fifty states, but know what is happening in your state or states
- Be ready to contact clients to make sure they know about upcoming tax changes
- If a lease is expiring, is time to leave?
- Or better, is there a new tax incentive your clients can take advantage of?

Questions?

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