M&A Sales Tax Hot Topics

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Agenda

- Impact of Wayfair in the M&A Paradigm
- Pre-Acquisition Considerations
- Post-Acquisition Implications and Remediation Factors
- Other Concerns

Sales Tax Paradigm – Legacy Sales Tax Pyramid

The US sales tax structure/generally involves a three-tiered analysis. On the revenue side,

I. Sales Tax Nexus
   i) Traditional Sales Tax Nexus. Usually satisfied when the Company has an agent or employee who sets foot in the state for a business purposes. Having property in the state automatically allows the state to confer sales tax nexus upon the Company.
   ii) **Wayfair Nexus. If the Company does not have any in person activities in the state, a state can confer sales tax nexus upon a remote seller based solely on the sales/transactional thresholds. General thresholds are $100K a year and/or 200 transactions per year.**

II. Taxability. Sale or lease of tangible is always taxable as determined by location where title/possession is transferred/occurs). Taxability of services varies among the states

III. Functionality (Exemption Certificates)

so that, on the sales side, if a remote seller (Company) has the requisite sales tax nexus, they are required to file a sales tax return and then examine a) whether what they are selling is taxable; and b) if taxable, does the remote seller have the requisite exemption certificates and/or collected the requisite sales tax from its customers.

Wayfair Considerations

How do you measure $100K?

a) Gross Sales v. Taxable Sales
   i) In Tennessee, Exempt services and Exempt Sales are Excluded, but resale transactions are Excluded.
   ii) In Georgia, Exempt Sales are Included, but Exempt Services and Resales are Excluded
   iii) In Indiana, Exempt Sales and Exempt Services are Included.
   iv) In Arkansas, Exempt Sales and Exempt Services are Excluded

b) Marketplace Sales (Tennessee Excluded. South Carolina Included)

Polling Question #1

Are there states which currently do not require sales tax registration based on Wayfair thresholds?

A) Yes
B) No
C) Yes, and this is a trick question
D) No, and this is a trick question

Before the "Deal": Pre-Acquisition Considerations

- Begin at the beginning—the importance of tax due diligence
  - Critically important for buy side <u>and</u> sell side
  - Strong indemnities and healthy escrows
    - False sense of security?
  - Responsible person designation and enforcement uptick
- Sales Tax Diligence Process

  <u>NEXUS</u>
    - Post-*Wayfair* world
    - Remote work
    - Limitations on tax departments create compliance pressure

Before the "Deal": Pre-Acquisition Considerations

TAXABILITY

- Most-Often-Missed
  - Roles/responsibilities of the marketplace facilitator
  - Taxable services
  - Digital goods
  - Sales tax implication of the deal itself (*in many cases, more material than historical liabilities)
    - Sale of an intangible interest vs. tangible goods
    - Applicable exemptions
    - Purchase price allocation and its impact to sales and real estate taxes at closing

Before the "Deal": Pre-Acquisition Considerations

EXPOSURE QUANTIFICATION

- What does "materiality" mean today?
  - TDD vs. ASC 450
  - Increased nexus profiles drive new risk assessment on states (low/medium/high)
  - Integration in Buyer's structure
- Remediation options prior to close
  - Avoidance of purchase price adjustments
  - Challenges to meeting those objectives
    - Ex. limited staffing at state level
- Negotiation Viewpoints of Buyer and Seller teams
  - Market conditions driving greater reliance on indemnity and escrow
  - Reps & Warranty Insurance

Polling Question #2

Agree or Disagree: In your transactions experience, you spend the most time addressing sales tax liabilities.

A) 1000% Agree

B) Disagree- no big deal here…pun intended

C) This is state tax and by default it must be a grey answer so I'm picking C or "it depends"

After the "Deal": Post-Acquisition Considerations

- Clean-up of both items identified during tax due diligence as well as unanticipated items can often be addressed similarly.
  - <u>Voluntary Disclosures</u>
    - Normally sales tax focused in asset sales
    - However, reporting entity will also want to address other tax exposures!
  - <u>Tax Amnesties</u>
    - Varies from state to state, year by year
  - <u>Other Resolution Methods</u>
    - Offer in Compromise
    - Litigation
    - Payment Plan

Voluntary Disclosure

- Most states provide for a voluntary disclosure process.
- ***Pros:***
  - Limited lookback periods
  - Waiver of Penalties (*and sometimes interest*)
  - Many states permit anonymous VDA applications
- ***Cons:***
  - Generally require no prior contact with state!
  - Not every state permits anonymity (*ex – NY*)
  - May require engagement of in-state counsel to assist (*ex – OH*)

Voluntary Disclosure

- MTC offers a unified VDA program
  - Useful when faced with liabilities in multiple states
- ***Pros:***
  - Unified Application
  - Permits anonymity during application process across the board
  - MTC staff act as intermediaries
- ***Cons:***
  - Timeframe for completion can be long
  - Not every state participates in the MTC program!
    - AK, CA, IL, IN, ME, MS, NV, NY, OH, PA, VA, & WY do not participate
    - LA participates at state level only -- ***NOT AT PARISH LEVEL!!!***

Other Tax Mitigation Strategies

- <u>Amnesties</u>
  - Possible alternative if disqualified from a state's VDA program
  - Can even be a better approach by further limiting lookback period!
    - *Ex – CT holding amnesty program open from Nov. 1, 2021 – Jan. 31, 2022 for **tax periods on or before Dec. 30, 2020**!*
    - 2021 Amnesties -- CT, GA, IN, IA, KY, MI, NV, NJ, NC, ND, OH, OK, SD, TN, UT, VT, WV, & WI
- <u>Compromises</u>
  - Generally require showing of inability to pay / doubtful collectability, or doubtful state claim
  - May require institution of litigation to pursue (*especially if not based on inability to pay*)

Other Tax Mitigation Strategies

- Litigation
  - ***Pros:***
    - Can result in limited or no tax liability
  - ***Cons:***
    - Cost
    - Time Consuming
    - Risk of Loss
    - Attorney fee shifting provisions
- Payment Plans
  - Many states offer payment plan options.
  - Interest can be steep!

Polling Question #3

What is your biggest concern in dealing with post-acquisition matters?

A) Managing VDA processes for liabilities identified during pre-sale due diligence.

B) Dealing with unanticipated tax liabilities / audits.

C) Sufficiency of indemnities and escrows.

D) No concerns here -- "Worry often gives a small thing a big shadow."

Other Concerns

- Transactions among Related Entities
- Transfers on Entity Formation/Liquidation
- Stock Deal vs. Asset Deal
- IRC § 338(h)(10) Elections
- Disregarded Entity Transfers

Other Concerns

- Occasional or Casual Sale Exemption
  - Prohibitions for License Holders
  - All, Substantially All, or Identifiable Segment?
  - Single Purchaser
  - Single Transaction
  - Time Limitations
  - Inventory or Other Specified Assets/Asset Classes

Other Concerns

- Other Potential Exemptions
  - Sale for Resale
    - Exemption Certificate
    - Buyer Registration
  - No Consideration
  - Use-Based Exemptions
  - Characterization of Property

Polling Question #4

Whose "Problem" is Successor Liability?

A) The Buyer's
B) The Seller's
C) The State's
D) Everyone's

Other Concerns

- "Bulk Sale" Transactions
  - Successor Liability
  - Notice – Pre-Closing or Post-Closing
  - Escrow/Holdback & Limitations
  - State Duties & Consequences of State Failures
  - Risks & Benefits

Other Concerns

- Registration Issues
  - New Registration Requirements
  - Change of Responsible Officers
  - Interim Operation During Regulatory Clearance
  - Impact of FEIN Transfer

Other Concerns

- Real Estate Transfer Taxes
  - Who Pays
  - Taxable Event
    - Sale of Property
    - Transfer of Interest in Property or Entity
  - Paid on Transfer, Recording Deed, or After

Other Concerns

- Real Estate Transfer Taxes
  - State-Specific Exemptions
  - Deductions from Purchase Price
  - Purchase Price Allocation & Apportionment
- Property Tax Implications

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Questions?