

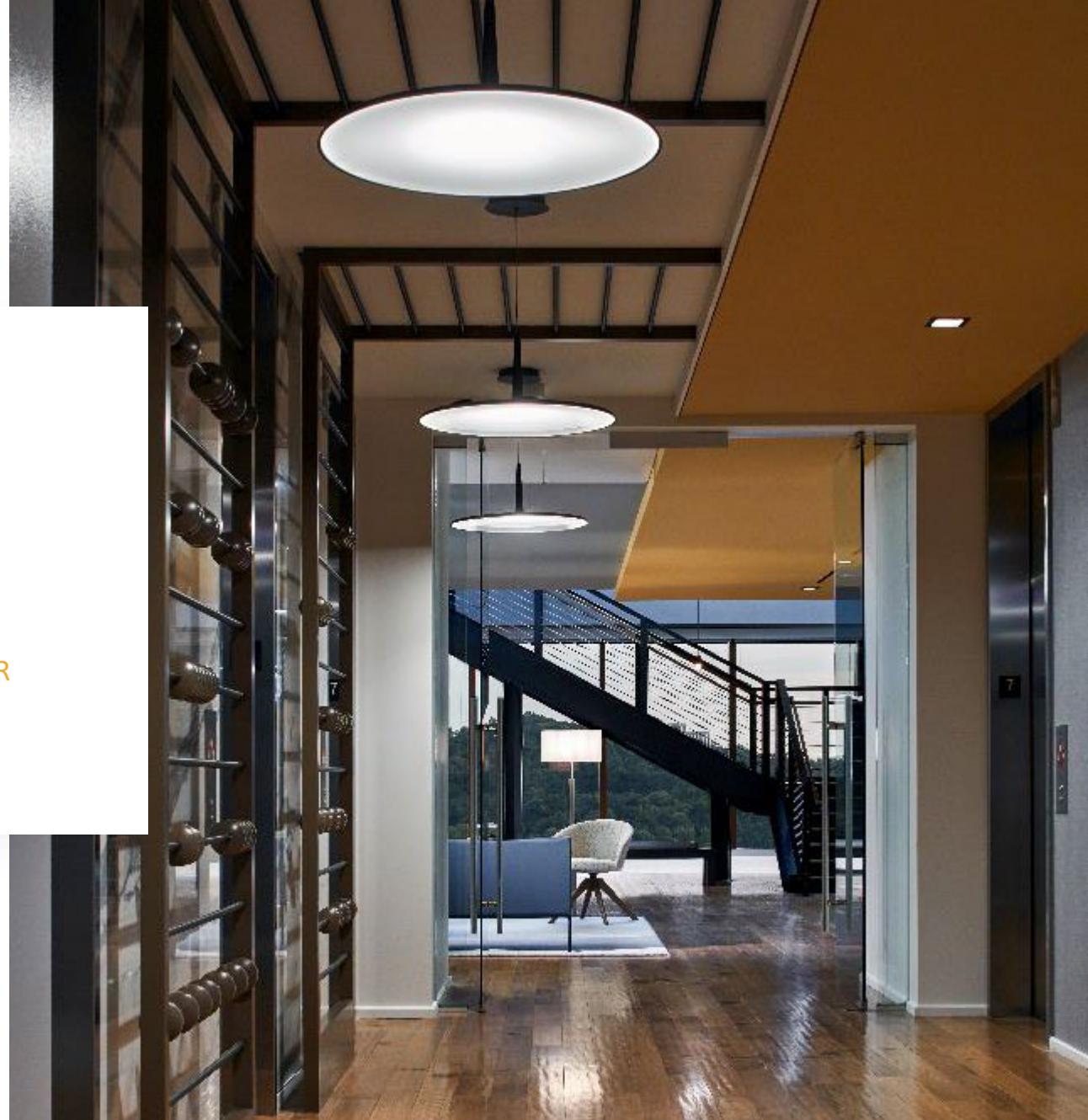


State and Local Tax:

Navigating Complexities in Sales Tax

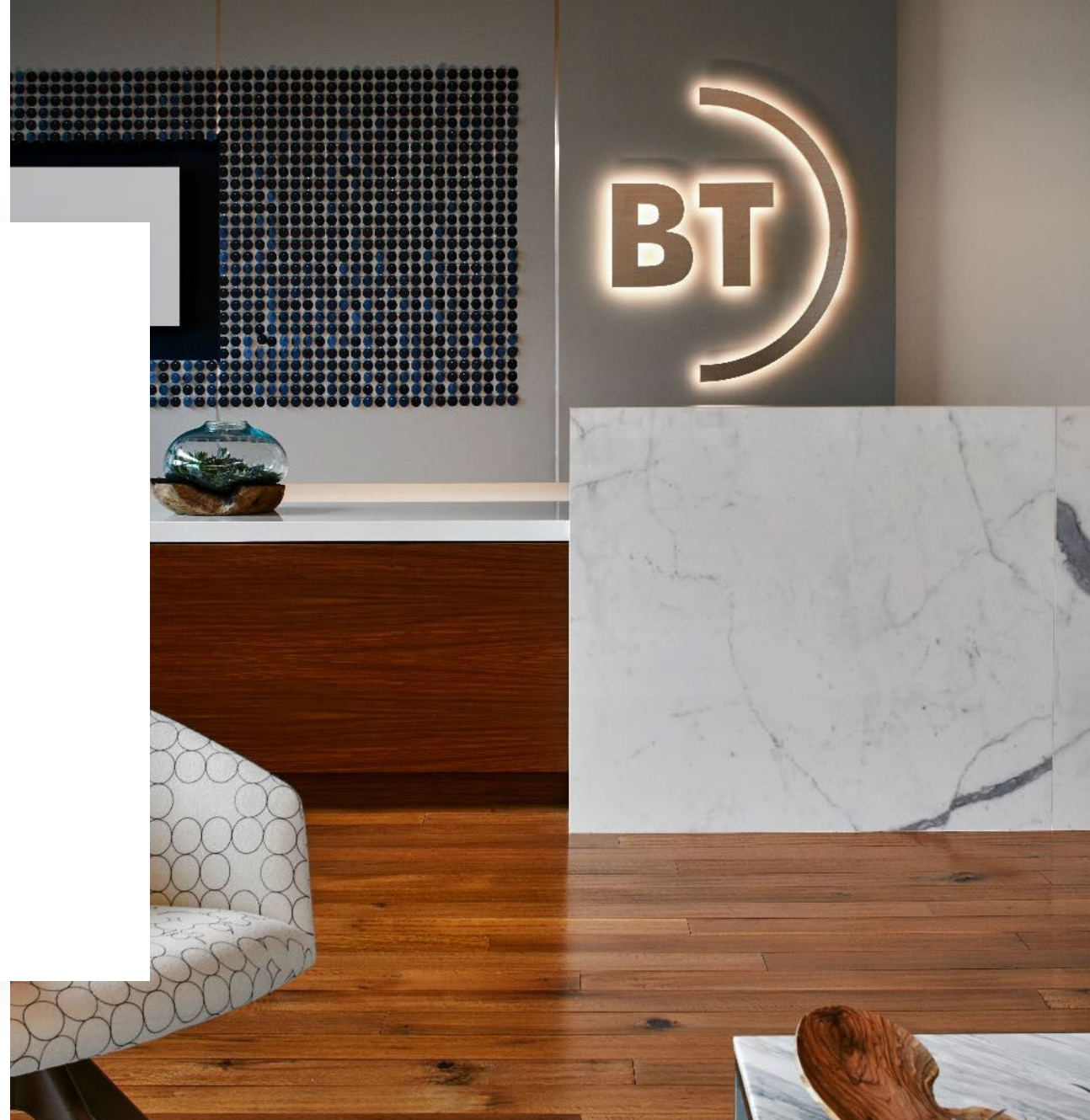
LEA September 26, 2024

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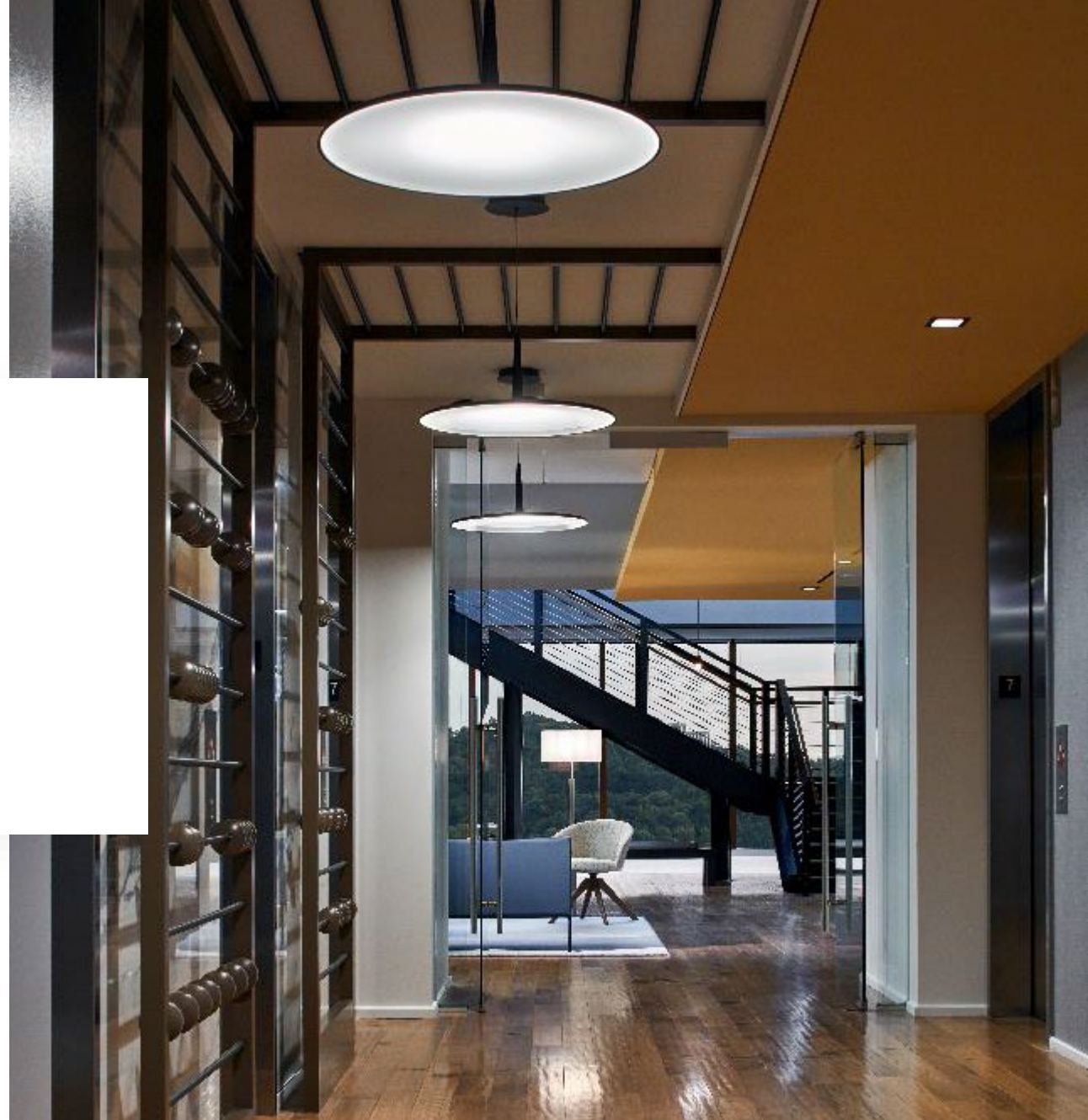
Agenda

1. Updates
2. Industry Considerations
 1. Manufacturing
 2. Contractors
 3. Retailers
3. Audits and managing risk





2024 SUT Select 2nd Half Updates*



Texas

- The Texas Comptroller of Public Accounts issued guidance on the sales and use taxability of separately stated credit card processing fees billed by a retailer to customers for the purchase of taxable items.
- The Comptroller said that such fees "are taxable as part of the total sales price of a taxable item." The retailer, the Comptroller explained, is not extending credit to the customer for the purchase of an item, but rather is accepting the credit card as a means of payment. As such, the processing fee "is not a finance, carrying and service, or interest charge from extending credit." The Comptroller also found that separately stated credit card processing fees "do not qualify for exclusion from taxable data processing services." The Comptroller noted that legislation enacted in 2021 clarified that "data processing" does not include the processing of electronic payment transactions. The Comptroller further explained that the retailer, in passing along the cost of the credit card processing fee to its customers is passing along the cost of an expense incurred in connection with the sales of a taxable item. Tex. Comp. of Pub. Accts., Memorandum # 202406004M (June 27, 2024).

Texas Cont'd

- The Texas Comptroller of Public Accounts has ruled that materials that are incorporated into the construction of railroad tracks or roadbeds are essential to the operation of locomotives and trains and are exempt from sales and use tax. This includes items such as sub-ballast, riprap, and steel and precast culverts. Texas Private Letter Ruling No. 202407022L, 07/24/2024
- The Texas Comptroller of Public Accounts has ruled that a residual fee, which is received by the taxpayer under a referral agreement with a credit card processor to promote the processor's services to the taxpayer's retail and hospitality clients, is not subject to sales and use tax. Texas Private Letter Ruling No. 202407021L, 07/24/2024

Massachusetts

- The Massachusetts Department of Revenue announced that an amnesty program will be open for eligible taxpayers from November 1, 2024, through December 30, 2024.
- Most penalties will be waived for eligible taxpayers who submit an amnesty request on MassTaxConnect beginning November 1, 2024. Taxpayers must file all required returns and pay all tax and interest included in the amnesty request by December 30, 2024. Tax Amnesty 2024 Announced, Mass. Dept. of Rev., 09/19/2024

Alaska

- Alaska Creates Exemption for Certain Electricity Storage and Creation Facilities
- An electricity generation facility or electricity storage facility that is constructed and placed into service on or after July 1, 2024, is not subject to state and local ad valorem, income, and excise taxes. L. 2024, H307 (c. 24), effective 08/01/2024.

Illinois

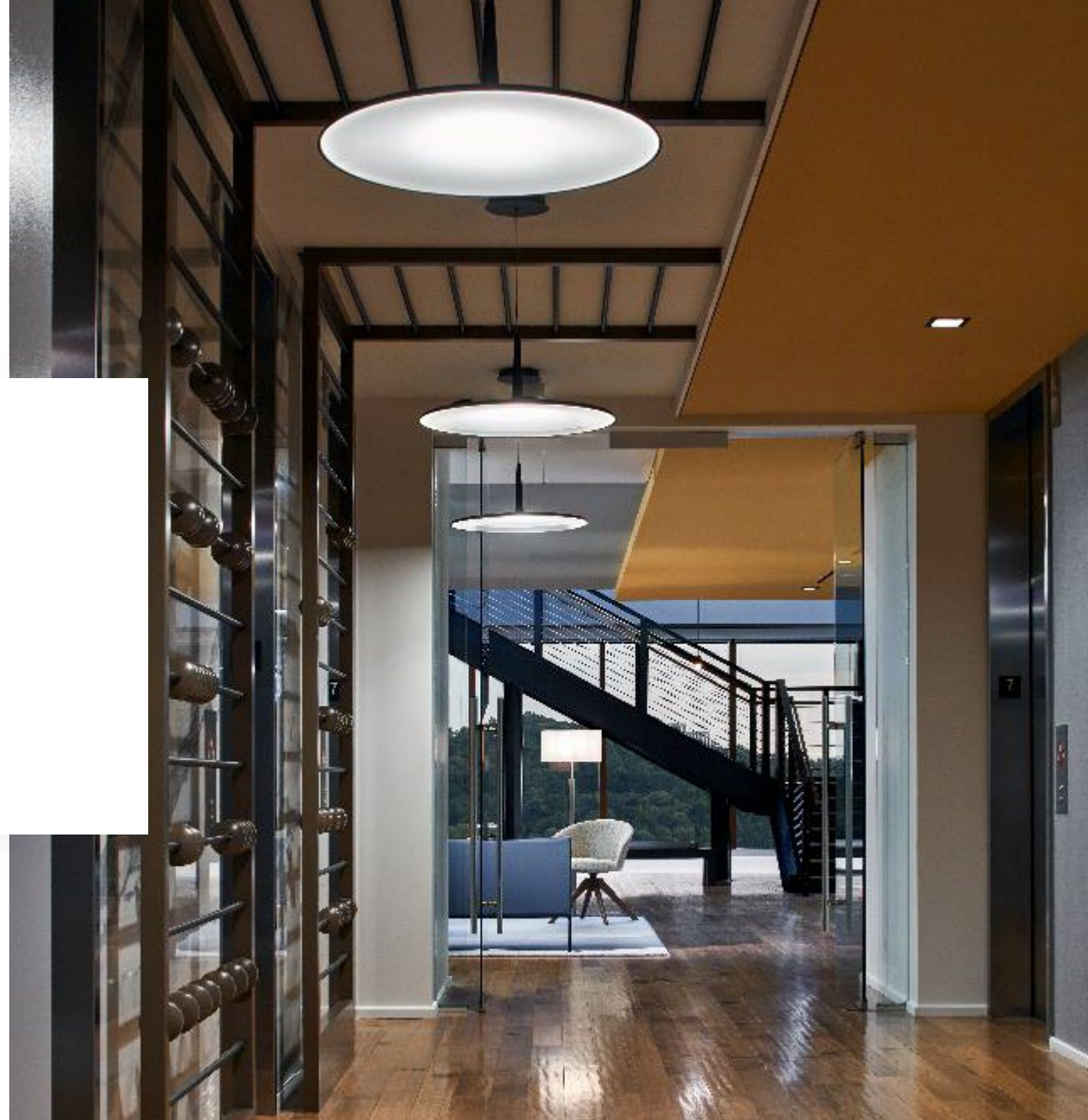
- Illinois Repeals Grocery Tax and Amends Direct Pay Permit Requirements
- Governor J.B. Pritzker signed legislation August 5, 2024 repealing the state grocery tax and creating an exemption for food prepared by certain licensed entities. While the law reduces state tax, it authorizes localities to adopt grocery taxes.
- Governor J.B. Pritzker signed legislation on August 9, 2024, to require each holder of a direct pay permit, by March 31, 2025, and by March 31 of each year after, to review its purchase activities made during the 12-month period ending on December 31 of the immediately preceding calendar year were sourced correctly, and that the correct tax rate was applied.

Missouri

- Sales tax exemption authorized for certain nuclear facilities.
- L. 2024, S1388, effective 08/28/2024, authorizes a state and local sales tax exemption for all sales and purchases of tangible personal property, building materials, equipment, fixtures, manufactured goods, machinery, and parts for the purposes of constructing all or any portion of a nuclear security enterprise located in any city with more than 400,000 inhabitants and located in more than one county. A “nuclear security enterprise” means the physical facilities, technology, and human capital of the national security laboratories and the nuclear weapons production facilities, inclusive of buildings, structures, and infrastructure constructed for use as a defense nuclear facility. The Act expires on August 28, 2034.



Industry SUT Considerations*



Manufacturing

Complexities faced by manufacturers.

- Manufacturing Exemptions: Many states offer sales tax exemptions for machinery, equipment, and raw materials used in the manufacturing process.
 - *The rules vary widely between states and applying the exemptions correctly is critical.*
- Taxability of Energy Consumption: Many states provide exemptions or reduced rates for electricity, gas, or other energy sources used in the manufacturing process.
 - *The challenge lies in determining how much of the energy is directly used in production versus administrative or non-production activities, which may not qualify for exemption.*
- Real Property vs. Tangible Personal Property: Installations and improvements made to manufacturing facilities may involve real property (e.g., buildings) and tangible personal property (e.g., machinery).
 - *The tax treatment will often hinge on this distinction.*
- Sales of Manufacturing Outputs: While manufacturing inputs like raw materials are often exempt, manufacturers must also understand the sales tax rules for the products they sell.
 - *Are the final products sold for resale, to exempt entities, or to taxable consumers?*

Contractors

Real property contractors are businesses or individuals that perform construction, improvement, repair, or installation work on real property (land and buildings). Their sales tax treatment is complex and requires careful consideration.

- Tangible Personal Property (TPP) vs. Real Property
 - *TPP refers to items that are movable and not permanently attached to land or buildings (e.g., appliances, tools, or furniture).*
 - *Real property includes anything permanently attached to land or buildings.*
- Contractor's Role as a Consumer vs. Reseller
 - *Contractors may be treated as the **end consumer** of the materials they purchase and use in a project, meaning they are responsible for paying sales tax on the materials at the time of purchase.*
 - *In other states, contractors can be treated as **resellers**, which allows them to purchase materials tax-free using a resale certificate, and then charge sales tax to their clients when billing for the job.*
- Taxability of Labor
 - Even within a single state, labor for some types of work might be taxable, while other types are not. For example, installation labor might be exempt, but repair labor could be taxable.

Contractors cont'd

- Taxation of Based on Job Type
 - *Some states differentiate between new construction, repair & remodel, and installation.*
- Different Contract Structures and Their Tax Impact
 - **Lump-Sum Contracts:** *In lump-sum contracts, the contractor charges one price for both labor and materials, without separating the cost of each. In states where the contractor is treated as the consumer, they would typically pay sales tax on materials at the time of purchase and not charge sales tax to the client.*
 - **Time and Materials Contracts:** *In time and materials contracts, the contractor separately bills the client for materials and labor. In some states, this can lead to the contractor needing to collect sales tax on both the materials and the labor charged to the client.*
- Exemption Certificates
 - *Understanding the client's role in a project as well as the nature of job and contract structure are all critical to determining taxability and which exemption certificates might be applicable on the purchase side as well as the sales side.*

****If your client is a real property contractor, talk to a sales tax advisor!****

Retailers

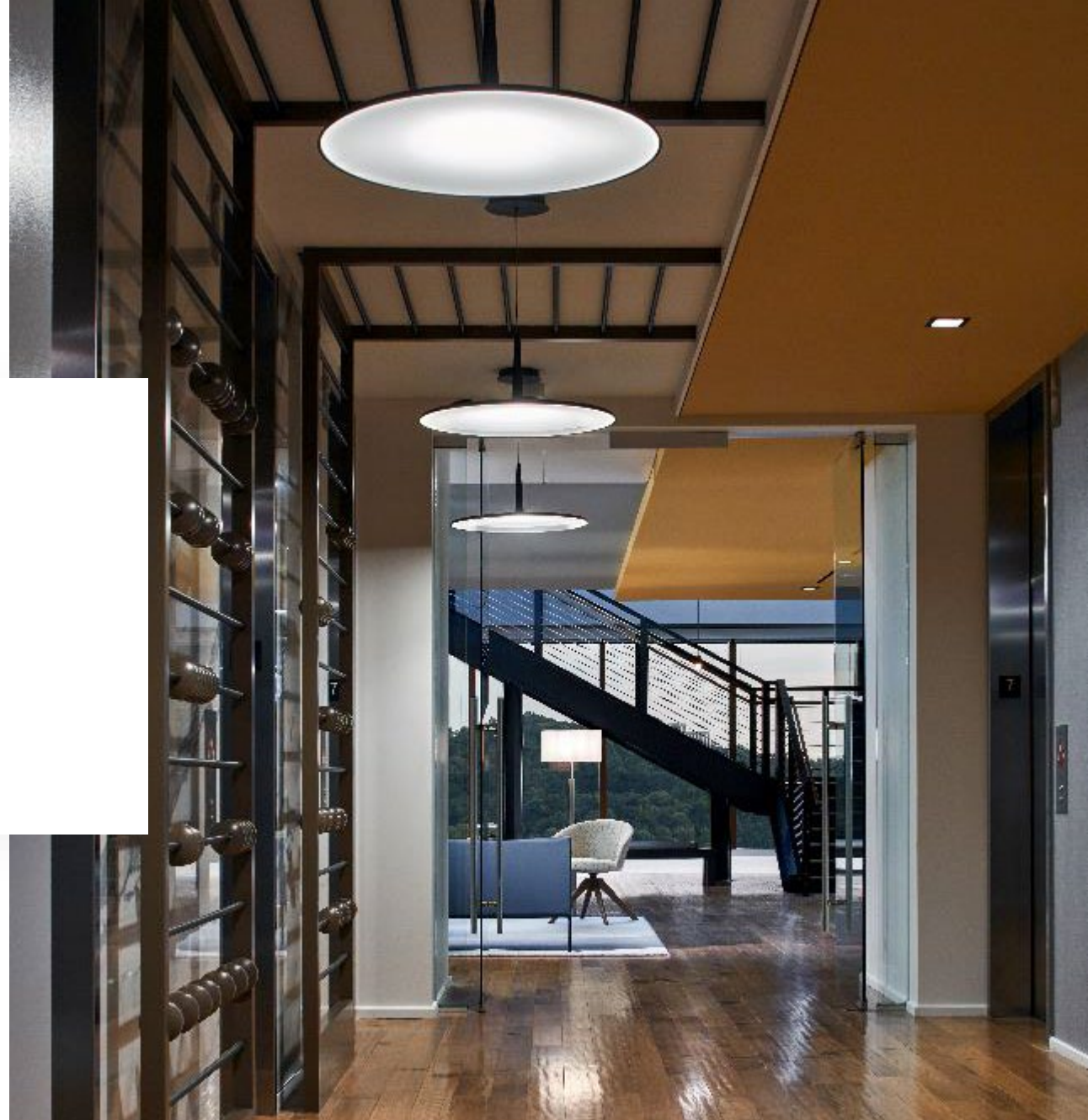
Having nexus creates a filing obligation.

- Physical Nexus: Having a physical presence (e.g., stores, warehouses, employees) in a state often creates an obligation to collect sales tax.
 - *You may create physical nexus in states you don't anticipate through your 3PL relationship.*
- Economic Nexus: Many states impose sales tax collection obligations based on a retailer's sales volume or number of transactions in the state, even without a physical presence in the wake of 2018's South Dakota vs Wayfair ruling.
 - *States may count gross receipts, not just taxable sales, toward economic nexus.*
- Click-through Nexus: Some states impose nexus if a retailer has relationships with affiliates or referrers in the state who generate sales leads.
 - *Out-of-state retailer (typically an online seller) has an agreement with individuals or companies in a state to refer customers via a website link (i.e., "click-through"), and if those referrals result in sales, the retailer may be required to collect and remit sales tax to that state.*

****If your retail client has nexus in a state and is not registered to collect sales there, talk to a sales tax advisor!****



Audits*



Audits

Common Triggers for Sales Tax Audits

- **High-risk industries:** *Certain industries, like retail, construction, or manufacturing, are often targeted due to the complexity of sales tax rules.*
- **Nexus expansion:** *Businesses that operate in multiple states or have recently expanded into new jurisdictions may trigger an audit if their sales tax filings raise red flags.*
- **Discrepancies in reporting:** *Inconsistent or unusual sales tax reporting (such as large deductions or exempt sales) may signal the need for a closer look.*
- **Third-party audits:** *If a business's suppliers or customers are audited, the auditor may also review transactions with the business, potentially leading to an audit of the business itself.*

Audits

Audit Process

- **Notification:** The state will send a notice to the business informing them of the audit. This letter will include a request for specific records, such as tax returns, exemption certificates, invoices, and sales records.
- **Documentation Review:** The auditor will review a range of documents on detail or sampled basis, including:
 - *Sales records to verify gross sales and tax collected.*
 - *Purchase records to ensure that tax was paid on items purchased for business use or to confirm the appropriate use of resale certificates for tax-exempt purchases. Auditors will also review any complementary use tax obligations.*
 - *Exemption certificates to validate any sales that were claimed as exempt from sales tax.*
- **Findings and Assessment:** After reviewing the documentation, the auditor will provide their findings. This could result in an assessment of additional tax, interest, and penalties if underpayment is discovered. This also presents an opportunity to review for any overpayments which could be used to offset identified underpayments.
- **Resolution:** Businesses can respond to audit findings, potentially appealing or negotiating reduced penalties. If significant underpayments are found, the business may also need to set up a payment plan.

Audits

It's important to help your clients manage audit risks

- **Nexus Tracking:** Ensure clients are aware of their nexus factors and are registering when nexus is observed.
- **Proper exemption certificate management:** Ensure clients collect, store, and maintain up-to-date and valid exemption certificates for all tax-exempt sales.
- **Use tax compliance:** Encourage clients to review their use tax obligations regularly, especially if they are purchasing goods from out-of-state vendors.
- **Accurate taxability determinations:** Help clients stay informed about the taxability of the products and services they sell, as tax laws vary widely by state and can change frequently.
- **Detailed and accessible records:** Advise clients to keep organized, detailed, and easily accessible records for all sales, purchases, and tax filings. This includes maintaining a proper trail for how they determined sales tax owed and any exemptions claimed.

