



TAX

US Federal and State Taxes For The Technology Sector

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AUDIT ■ TAX ■ ADVISORY

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Agenda

- ◆ **Introduction**
- ◆ **State Tax Overview**
- ◆ **Nexus**
- ◆ **Sales and Use Tax**
- ◆ **US Federal Income Taxes**
- ◆ **State Income Taxes**
- ◆ **Questions and Answers**

Types of State Taxes

- ◆ **Sales and Use Tax - 45 states, 7,000 + local jurisdictions**
- ◆ **Franchise Tax Based on Capital**
- ◆ **Franchise Tax Based on Alternative Methodology**
 - e.g., Washington B&O tax, Michigan SBT, Ohio CAT
- ◆ **Franchise Tax Based on Net Income**
 - Limited exemption under P.L. 86-272: Solicitation of sales of tangible personal property cannot create income tax nexus

State Taxation – What is Nexus?

- ◆ **Sufficient contact with a state to be subject to its tax jurisdiction**
- ◆ **Differing standards for different taxes**
- ◆ **Procedural tax law; not substantive**
- ◆ **State taxing power limited by US Constitution**

Do You Have Nexus?

- ◆ **Sales and Use Tax – mere physical presence**
- ◆ **Franchise Tax – mere physical presence**
- ◆ **Income Tax – an out-of-state company cannot be subject to state income tax where in state activities do not exceed solicitation of sales of tangible personal property.**
- ◆ **Third parties (i.e., independent reps. and agents) can create nexus**
- ◆ **Nexus can exist even if no PE under the Treaty**

Activities Exceeding Solicitation

- ◆ Installation or implementation services
- ◆ Licensing of software in some states
- ◆ Approving or accepting orders; taking deposits
- ◆ Carrying samples for sale
- ◆ Collecting delinquent accounts or repossessing property
- ◆ Non-sales training classes
- ◆ Hiring, training, or evaluating personnel other than sales personnel
- ◆ Investigating creditworthiness
- ◆ Instate property – e.g., inventory

Sales and Use Tax

- ◆ Generally applies to sales of tangible personal property to end users
- ◆ Can apply to services
- ◆ Applies to property brought into state (use tax)
- ◆ Bulk or occasional sales rules – M&A
- ◆ Many exemptions (resale, manufacturing, incentive zones)
- ◆ Imposed upon transactions between all legal entities, including related and disregarded companies
- ◆ Hard copy of certificate required
- ◆ Certificate must be taken in good faith
- ◆ Direct pay permit

Sales and Use Tax Rates

- ◆ **Total tax rates range from 3-10%**
- ◆ **Total sales/use tax rate includes a state tax rate and some combination of local tax rates**
- ◆ **Local rates may include city tax, county/parish tax, and special district taxes such as a Metropolitan Transit Authority (MTA) tax**
- ◆ **Most states set a cap on the total tax rate allowed on one transaction**

Difference Between Sales and Use Tax

- ◆ Sales tax applies to *intrastate* sales
- ◆ Use tax applies to *interstate* sales and “use” of property resulting from an interstate transfer
- ◆ Vendor required to collect sales or use tax if it has nexus in the state
- ◆ Sales and use taxes are complimentary and are generally imposed at the same state tax rate
- ◆ Sourcing rules may differ between sales and use tax for local tax rates – vendor location or destination
- ◆ Certain exemptions may only apply to one of the two taxes

Sales and Use Tax – How is it Imposed?

- ◆ **Vendors required to collect sales or use tax on ALL taxable sales to customers and remit the tax to the state if vendor has nexus.**
- ◆ **Purchasers of taxable items required to remit sales/use tax to the state on all taxable purchases unless tax was properly paid to the vendor.**
- ◆ **Final responsibility for the tax varies by state (seller, consumer, or both)**
- ◆ **Sales and use tax returns are reported on a monthly, quarterly, or annual basis depending upon the state and degree of activity**

Sales and Use Tax – Exemptions

- ◆ Many exemptions available, vary by state
- ◆ Exemptions are strictly construed
- ◆ May require burden of proof on both seller and purchaser
- ◆ Exemption certificates must be attained to justify under audit
- ◆ Most common sales and use tax exemptions
 - Resale
 - Manufacturing
 - Occasional Sale
- ◆ Electronic download exemption

Sales and Use Tax – How To Apply To Your Company?

◆ What am I providing to my customers?

- Sale of tangible personal property (resale, mfg, consumer)
- Sale of a nontaxable service (consumer)
- Sale of a taxable service (resale, consumer)
- Combination of product and service

◆ Providing a service or renting equipment?

- Equipment rental can be taxable
- Did lessor pay sales/use tax up front?
- Is charge for operator taxable?
- Are charges separately stated on invoice?

Some More Sales Tax Issues

- ◆ **Intercompany transfers of equipment from Canada to US**
 - Retained ownership by Canco creates nexus
 - Initial capital contribution – generally not a taxable sale
 - Sale between affiliates or parent and subsidiary
- ◆ **Credit for sales tax paid to another state generally available**
- ◆ **Credit for GST/PST generally not available**

Sales and Use Tax - Do Not Make It Your Tax

- ◆ **Collected from purchaser at time of sale by vendor and remitted to state**
- ◆ **If you do not collect but you were required to, tax can be imposed against you**
- ◆ **Contractual terms as between buyer and seller not relevant to state tax authorities**

Streamlined Sales Tax Project (SSTP)

- ◆ **US remains the sole industrialized country that does not impose a national, broad-based consumption tax**
- ◆ **45 states, the District of Columbia (DC) and thousands of localities currently impose sales and use tax**
- ◆ **Inconsistencies among taxing jurisdictions are a disincentive for tax compliance resulting in a loss of revenues**

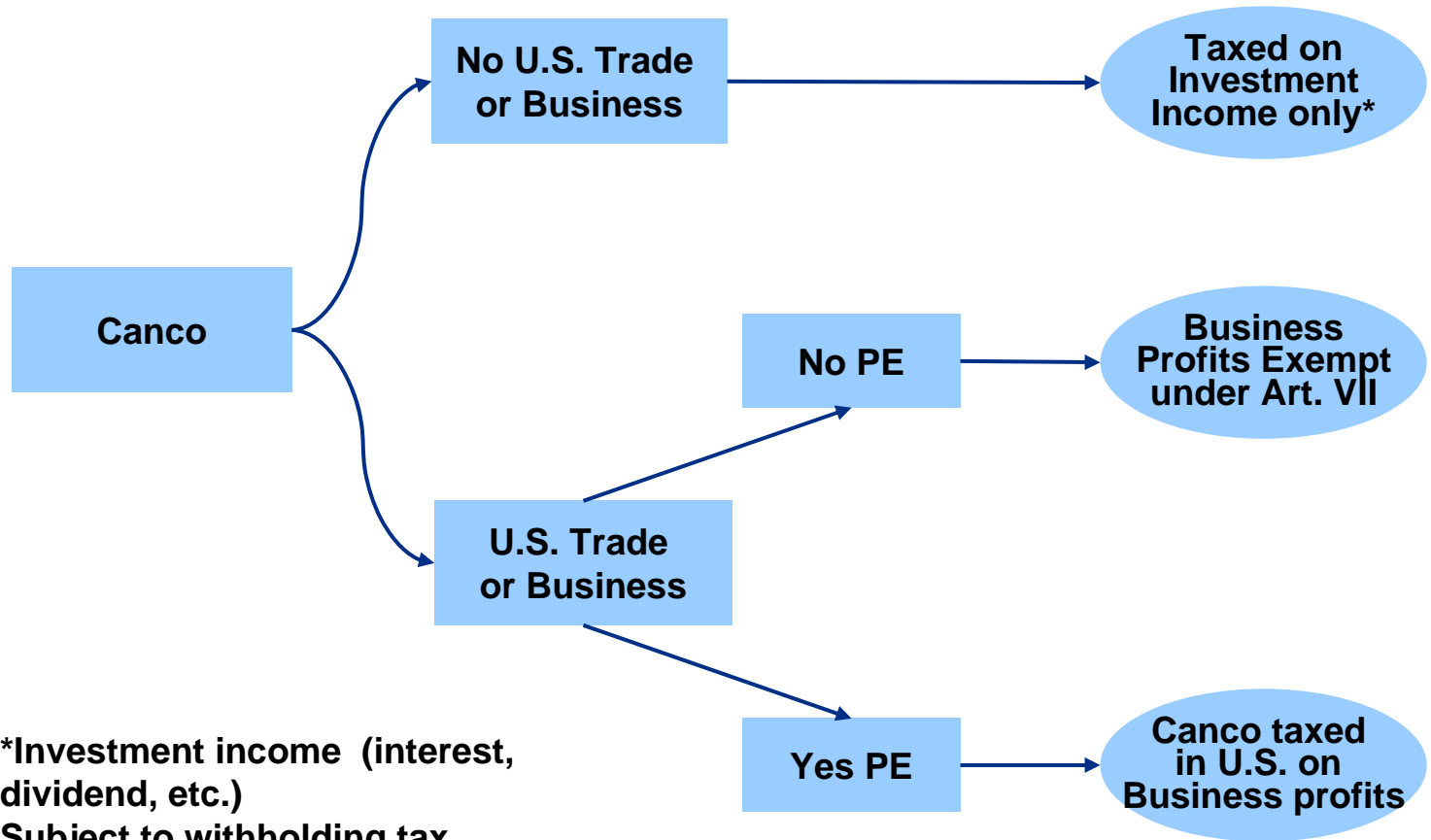
Streamlined Sales Tax Project (SSTP)

- ◆ **Purpose is to simplify and modernize sales and use tax collection and administration with the goal of increasing revenues**
 - Tax law simplifications
 - More efficient administrative procedures
 - Use of emerging technologies to reduce the collection burden
- ◆ **21 states have enacted conforming legislation**

US Federal Tax Basics

- ◆ **Domestic (US) corporations taxed on world-wide income**
- ◆ **Foreign corporation taxed on business profits with a US trade or business**
- ◆ **Trade or Business – Based on facts and circumstances (e.g., soliciting sales through an employee on a regular and continuous basis)**
- ◆ **Canada/US Treaty protects Canadian corporations from US taxation of business profits absent a US Permanent Establishment (“PE”)**
- ◆ **Canadian Corporations taxed on Business Profits from a US PE**
- ◆ **Generally no US federal sales taxes but watch for specialized excise taxes**

US Federal Tax Basics



***Investment income (interest, dividend, etc.)
Subject to withholding tax**

What is A Permanent Establishment (“PE”)?

- ◆ **Defined under Article V of Canada-US Treaty**
- ◆ **Fixed place of business including:**
 - A place of management
 - A branch
 - An office
 - A factory
 - A workshop
 - A mine, an oil or gas well, etc.
- ◆ **Other factors that create PE include authority to conclude contracts in the US or a dependent agent that has a PE as opposed to an independent agent in the US**

What is NOT a PE?

Activities exempt from PE:

- ◆ Use of facility for storage, display or delivery
- ◆ Maintenance of goods for storage, display or delivery
- ◆ Maintenance of goods for processing by another person
- ◆ Advertising, supply of information or scientific research

Convergence of Nexus and PE

- ◆ **Reminder: US/Canada tax treaty does not eliminate federal tax return filing obligations**
 - Protective returns required to claim treaty benefits
 - Significant penalties can apply for nonfiling
 - IRS could disallow deduction of expenses against receipts if returns not filed and you are audited
- ◆ **Permanent Establishment (PE) = Subject to US Fed Tax**
- ◆ **Physical Presence = Subject to State Taxation**

States Are Not Parties to the Tax Treaty

- ◆ **States are not bound by the Treaty**
- ◆ **Some states continue to aggressively seek out Canadian nonfilers**
- ◆ **State level income or franchise tax can apply even if US federal income tax does not**
- ◆ **The Treaty can impact state income tax calculation (federal conformity)**
- ◆ **A zero return can be required**
- ◆ **The Treaty has nothing to do with sales taxes**

State Income Tax Basics

- ◆ **Federal Conformity - Moving vs. Static**
 - Current Internal Revenue Code or as amended through a fixed date
- ◆ **Nevada, South Dakota, Washington, Wyoming have no income tax**
- ◆ **State taxation can be based on branch or worldwide equivalent basis**

State Income Tax Basics

- ◆ Are you in a “treaty state”?
- ◆ Are you in a “worldwide taxability state”?
- ◆ Are you in a unitary state (common west of Mississippi River)?
- ◆ Do related party add back provisions apply?
- ◆ Should you operate as a “branch” or a separate entity?
- ◆ What kind of entity – flow through, corporation, hybrid?
- ◆ Withholding tax on cross border interest, dividends or royalties?

Practical Advice

- ◆ **Must you register? If you have nexus, generally yes**
- ◆ **Basic information, can be done online**
- ◆ **Caution if you have prior unreported nexus**
- ◆ **Anticipate your tax filing responsibilities**
 - Secure a federal taxpayer ID number
 - Register/qualify to do business with state Secretary of State
 - Register as vendor with state tax authorities
- ◆ **Consider local taxes**
- ◆ **Takes time to complete and process**

How Canadian Companies Get Caught

- ◆ **Information sharing**
 - US Customs Service
 - Internal Revenue Service
 - Other state tax authorities
- ◆ **Audits of other taxpayers**
- ◆ **Questionnaires**
- ◆ **Weigh station inquiries**

Common Multistate Tax Oversights

- ◆ **Activities conducted by third parties can create nexus**
- ◆ **Nexus can exist even if no PE under US Canada treaty**
- ◆ **Returns may be required even if no tax is due**
- ◆ **Failing to obtain certificate of authority from state secretary**
- ◆ **Failing to register with state tax authorities or doing so with incomplete, incorrect or inaccurate information**

Common Multistate Tax Oversights cont.

- ◆ **Not securing exemption certificates from customers**
- ◆ **Not collecting sales tax or worse, not remitting collected sales tax**
- ◆ **Not documenting states visited by out of state employees**
- ◆ **Not responding to inquiries from state tax authorities**
- ◆ **Completing state questionnaires without professional help**

Practical Advice - Implications of Noncompliance

- ◆ **Accurate information for old periods not available – estimates used**
- ◆ **Exposure to multiple penalties and interest**
- ◆ **Your customer's sales tax can become your tax**
- ◆ **Statute of limitations on assessment never starts to run**
- ◆ **Director and officer personal liability**
- ◆ **Financial statement disclosure**
- ◆ **Loss of treaty protection if return not filed**
- ◆ **Criminal sanction**

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