Tax in tech: Understand SALT impacts

Transcript

CHRISTOPHER SUMMER: Hello, my name is Chris Summer, a partner with Grant Thornton, and I lead our technology initiative for the Tax practice. I'm joined today by Dana Lance, our State and Local Tax Practice leader and Jamie Yesnowitz, a leader of our State and Local National Tax group. Thank you guys for joining us today.

DANA LANCE: Glad to be here.

JAMIE C. YESNOWITZ: Thank you, Chris.

CHRISTOPHER SUMMER: So, what are some of the top issues you're seeing for technology companies in the state and local tax space?

DANA LANCE: There are so many unique issues facing the technology industry today. One of the biggest challenges that I think we see is just how rapidly the industry has been changing over the years, and often the state tax laws have not kept pace with the modern business economy as we know it today. So, when we think about some of the key state and local tax challenges, we're really talking about things such as controversy challenges related to the sourcing of electronically delivered goods and services, to indirect tax matters such as taxability of different electronically delivered goods and services in particular, as well as a lot of opportunities for all the investment that the technology industry is making in new technologies around the country and opportunities for cash savings that that presents. Jamie, what do you think, and what are you seeing in the technology industry today?

JAMIE C. YESNOWITZ: Well, I think it's a terrific way to set that up, Dana. The state and local tax laws were created a really long, long time ago. States can't keep up with it because of the advances in technology that have changed the scope of what businesses are selling today. You see it in the area of nexus, both on the income tax side and the sales tax side, where it is much easier now for a state to require that a business either collect and remit for sales tax purposes, or be subject to the income tax in states in which they have no physical presence. The Multi-State Tax Commission, which is a group of state governments, decided that they want to whittle down the activities that would subject a business to a taxing obligation for income tax purposes with regard to sales factor apportionment. There has been a proliferation of guidance on how a state treats the sale of an item other than tangible personal property. Back in the day, all states cared about was whether a company was selling tangible personal property or selling something else. Now, there are all sorts of iterations of sales driven by technology — different types of services, different types of intangibles, and there are different sourcing rules for each of those types of products that are being sold. So, we're seeing a lot of diversity amongst states in the approaches in which they are trying to source sales of items sold by companies.

DANA LANCE: You know, Jamie, talking about the sourcing of electronically delivered goods and services — historically, states used a combination of cost of performance or market sourcing rules to source these types of revenues. More and more, I think we're seeing states trend towards market-based sourcing with reasonable approximation language for sourcing electronically delivered goods and services. What are you seeing in terms of different interpretations on reasonable approximation for determining how a sale should be sourced?

JAMIE C. YESNOWITZ: Well, it's certainly been the trend amongst the states that they've moved from cost performance to market-based sourcing. But market-based sourcing isn't the same thing from state to state. So, some states say look to where the customer is receiving the service, for example. There are other instances where states will say make some sort of reasonable approximation because you can't really figure out where an amorphous product is being sold, looking to a census type of approach to approximate your market. And it's interesting because when states audit this issue, some of the smaller companies may say, well, we're going to reasonably approximate because we can't access the data that's necessary to figure out exactly what the market's going to be. In contrast, some of the larger companies, at least there's the perception that they can reach that type of data where they don't have to reasonably approximate, where they have all the data in the world. They could figure out where the market is located, and so some states are saying, we know you have this data, we're going to make you source according to that data rather than allowing a reasonable approximation approach that would make things far more simplistic, if you will.

DANA LANCE: That's so true. You know what I see on controversy across the country is that what's reasonable for one company is not necessarily viewed to be reasonable for another company by the same jurisdiction. And that's creating a lot of complexities, I think, for taxpayers around the country. And what is the burden of proof that a taxpayer has? That's a question that I don't think we've seen answered in any court systems to date, but one that I think is probably coming in the near future hopefully.

JAMIE C. YESNOWITZ: It's going to vary from state to state. New York has an example where they offer up several different sourcing methodologies, and you're supposed to use the first one in the hierarchy of methods. And if you can't figure it out through that first method, you have to do enough due diligence to prove to the Department of Taxation that you've gone through your data, that there's just no way to satisfy the first method, and then you can advance to the second method. The state of New York is doing that to avoid perceived gaming of the system, using the method that would result in the lowest amount of sales to the state. So, I think the trend is going to be where you see many states take that approach, saying that we'll give you several different methods. There will be a preferred approach. You'll have to do some digging to either confirm that approach or confirm that you can't address that, and then move on to a second method, or a reasonable approximation method. So the plethora of methods in sourcing is happening because of technology, and I think technology companies are going to be challenged by those rules, probably even more so than traditional brick and mortar businesses.

DANA LANCE: So, talking about rules for the technology industry — is cost of performance sourcing still a thing?

JAMIE C. YESNOWITZ: Cost of performance sourcing still is, in Florida, Texas and Virginia being the three states with the biggest markets where one still looks to cost of performance in a variety of contexts. And that's important because, when a company is looking at cost of performance, they're looking at where their property and their payroll is located. And where their sales are located is not important for that particular state. And what that means is if you have a business that's located multi-state, it has a lot of costs in Virginia or Florida or Texas and it has a marketplace that's throughout. There's the potential for whipsaw where the company is essentially required to include its sales in more than one jurisdiction, which is obviously not the result that a company would want. So, the fact that there are still states out there, and still some large states out there, that use cost of performance sourcing, that's something to be concerned about if you're a taxpayer with that type of fact pattern. In contrast, there are situations where a company will be able to have essentially what we describe as nowhere sales, where some level sales will be included in a sales factor in any state because of Virginia and Texas and Florida saying well, we're not going to take the sale if your payroll and your property or a measure like that isn't in our state.

DANA LANCE: Yeah, definitely, when it comes to cost of performance, I'm seeing a very wide interpretation of where the income-producing activity occurs.

JAMIE C. YESNOWITZ: Thinking about this even a little bit more broadly, the technology industry is doing things that states have never envisioned would happen. And so states can either change the law through the legislatures, they can change the interpretation of the law through regulations, or they can go through the audit process and target particular technology companies as a means to get the revenue that the state feels that it needs. So, what it means from the perspective of an audit is companies really have to be very careful. The data problem that we've discussed certainly is something to be concerned about. I think that from the perspective of a multi-state company that has audits all over the country, it has to keep track of controversies all over the country, positions that might not be consistent from state to state. It can really be a challenge for companies with in-house personnel that are tasked with trying to manage these types of audits.

DANA LANCE: We've talked about state jurisdictions specifically targeting the technology industry. We're typically thinking in terms of some of the larger technology companies that dominate certain sectors of the technology industry, but the result of this is going to be really impactful for the broader technology industry, in my opinion, because of the ramifications of the trickle-down effect, right. So, startups, emerging technology companies, much smaller, newer technology companies that don't have sophisticated tax departments and infrastructures in place, to really comply with complex laws, are going to need to face the reality of a very complex tax system that is specifically focused on new creative ways to tax the technology industry as a whole. So, I think the ramifications of some of the technology industry focus that appears to be there from a taxing jurisdiction perspective right now is going to have pretty broad ramifications for the industry.