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CLARK NUBER P.S. | JOE HABERZETLE, JD LL.M.



THREE UNEXPECTED TAX AREAS THAT CAN IMPACT MANUFACTURERS

In a 2012 survey of corporate tax departments, the Tax Executives Institute reported that the most commonly used measurement by company management to evaluate the tax department's performance was "lack of surprises," beating out expected metrics such as "meeting compliance deadlines" and "cash taxes."

So it seems that avoiding ugly surprises is the way to succeed in the tax world – but how do we know what we don't know? Although every situation is unique, the following are a few areas where unexpected tax assessments, filing obligations and other rude surprises seem to crop up, again and again, in a wide variety of different companies and industries.

UNCOLLECTED SALES TAX EXPOSURE

Many CFOs and tax directors focus on federal and state income tax exposure but fail to realize that, if not properly addressed, sales tax exposure can dwarf income tax risk. This can be a blind spot for manufacturers – if sales are generally to resellers/distributors rather than end users, management may assume that sales tax is not an area of significant exposure.

However, state revenue departments typically assume all sales are taxable until proven otherwise. If a company has been lax about collecting and updating the required resale documentation, it can be a real headache to try to get it from customers on a short deadline that is months or years after the transactions in question.

If the company sells to the end user but does not collect and report sales tax to all of the states where customers are located, a different set of concerns arise. Physical presence in the delivery state triggers the obligation to collect sales tax, but many assume this means a company office or warehouse. It does not. A brief visit by a salesperson or independent broker to a single potential customer can obligate the company to collect tax on all subsequent sales to customers in that state – even if the original visit did not result in a sale!

Finally, what is subject to sales tax in the first place has shifted radically in the past 10 to 15 years, with the growth in electronically delivered products and services. Washington began imposing sales tax on a broad array of "digital products" and online services in 2009, and a number of other states have followed suit. The rush to the digital market has been so rapid that companies are just now starting to understand where these products and services may be subject to sales tax. Purchasers may be held liable for use tax (generally at the same rate as the sales tax) if the seller did not collect tax at the time of the sale.

GROSS RECEIPTS TAXES AND OTHER ALTERNATIVE TAXES

Most Washington business owners and executives are familiar with the Washington business and occupation (B&O) tax. Manufacturers are subject to B&O tax on their receipts from all Washington-manufactured products*. In recent years, quite a few other states have shifted to corporate taxes based on gross receipts, net worth or a similar non-income measure. In addition, 39 cities in Washington (including Seattle, Tacoma and Bellevue) impose a city B&O tax and are often aggressive in pursuing businesses located outside of their city boundaries for unpaid taxes.

A number of other jurisdictions impose a graduated "minimum" tax according to receipts from customers in the state or city. For example, Oregon's minimum tax can be up to \$100,000 per year, even if the company does not have a dollar of taxable income!

PERSONAL INCOME TAX WITHHOLDING ON MOBILE EMPLOYEES

Although Washington does not impose a personal income tax on earnings, 41 states do. When an employee travels to another state for business, the company generally has an obligation to withhold personal income tax on amounts earned by the employee while in that state.

Personal income tax is imposed on the employee, but states typically seek to collect it from the employer (with penalties) if the employer failed to withhold. Further issues arise if the business does not track employee work location. Adding work location to the company's employee time reporting software is possible, but can be expensive and disruptive to the business. Without verifiable records, though, a state auditor may assume (even with an out-of-state business) that all wages paid by the company are subject to the state's withholding. The burden is on the company to prove what work was not performed within the state.

The finer details about these unexpected tax areas could fill pages. Please consult your tax advisor or a Clark Nuber professional for more information.

* Although those Washington manufacturers with a substantial out-of-state customer base have long enjoyed the opportunity to reduce the B&O tax burden somewhat, using a captive sales company or, if the business has a substantial out-of-state manufacturing presence, a "processor-for-hire" subsidiary.

Joe Haberzette is a senior manager in Clark Nuber's State & Local Tax Practice. Reach him at JHaberzette@clarknuber.com