



Financial Adviser

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Multistate and Local Tax Considerations

As states are increasingly challenged by tightening budgets and public outcry against raising revenues through traditional property and income tax reform, states are examining other revenue opportunities. Most state revenue agents now aggressively pursue tax collection from taxpayers headquartered outside their state boundaries.

Now is a good time to examine your business and determine if you have exposure to the tax laws of other states. This area is complicated because each state has different laws and regulations. Accordingly, a company, with identical operations in two different states, can easily have entirely different state tax liabilities and exposures. Therefore, in every state that your company has activity, research needs to be performed to determine how its laws specifically apply to your business.

In general, there are three different types of tax which need to be reviewed:

- tax on the sale of goods and/or service – sales tax
- tax on income in the state – income tax
- tax on the use of capital in the state – franchise tax

A state can only impose taxes if the business has sufficient nexus (contact) with that particular state. Unfortunately, the activities that determine nexus are not uniform among states and even differ within some states depending on the type of tax assessed.

Sales Tax

Most states impose a tax on the transaction of selling tangible personal property. Some states extend this tax to certain services performed within the state. This tax is referred to as a "sales tax." Many states have a companion tax, the "use tax," which is imposed on the entity that uses or consumes the tangible personal property within the state. The requirement to collect the sales or use tax is triggered by having a physical presence in the state. This requirement is normally met if you have an office, a warehouse, inventory (including consigned inventory) or any real or tangible

property located in the state. Most states include in their definition of physical presence the employing of personnel in the state. The use of independent contractors to solicit sales is often sufficient nexus based on longstanding court cases.

Although the sales/use tax is imposed on the end-user — your customer, it can be assessed against the seller in the event the state does not collect the tax from the user, along with interest and penalties. If you are selling goods to the end users in other states, you could be accumulating substantial financial exposure in these states.

Income Tax

In order for a business to be exposed to a state's income tax it must have a physical presence that exceeds the solicitation of sales. While presence to solicit sales is sufficient to trigger exposure to the sales tax, Federal Public Law 86-272 prohibits states from imposing income tax on businesses whose activities do not exceed the solicitation of the sale of tangible personal property (if the order is accepted outside of the state and is filled from inventory by shipping or delivery from outside of the state). Activities that go beyond asking for the sale (training, installation, in-state warranty repairs, etc.) are not protected by the federal law and therefore subject a business to state income tax.

Franchise Tax

A number of states have taken the position that their franchise tax is applicable to businesses that have any physical presence. They premise that Federal Public Law 86-272 does not apply to a tax measured on capital and many state courts have agreed. If your business has assets (buildings, equipment, etc.) in other states, you may be subject to franchise tax.

Unfortunately ignoring this complex area is not the answer since the potential liability continues to grow. Now is the time to determine your company's financial exposure and assess any compliance measures that are necessary. ★

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