Sales Tax Considerations in Asset and Equity Acquisitions

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Agenda

- Overview of State Sales Tax Regime
- Sales Tax Liabilities in Asset vs. Equity Deals
- Specific Sales Tax Implications/Concepts
  - Sales Tax Exemptions
  - Bulk Sale Procedures/Tax Clearance Certificates
  - VDA Programs
- Drafting Reminders

Sales Tax Basics

- Sales tax is imposed at the state and local level in the U.S. — there is no federal sales tax.
- In the U.S., there is roughly 13,000 sales and use tax jurisdictions.
  - There are five states that do not impose a general state sales tax:
    - New Hampshire
    - Oregon
    - Montana
    - Alaska
    - Delaware
- Each state and locality has their own unique sales tax rules – e.g., imposition, exemptions, nexus, sourcing.

Sales Tax Basics

- Sales tax is generally a consumption tax imposed on sales to end consumers. Sales made along the supply chain to parties other than the end consumer (e.g., resales) are generally not taxable.
- Unless an exemption applies, sales tax is generally imposed on all sales of tangible personal property and certain enumerated services.
  - The sale of intangibles/goodwill are generally not taxable.
  - Hot area: digital products/software (as well as other emerging technologies and innovations)
- The economic burden of the sales tax is generally borne by the consumer, but the tax is collected and remitted by the seller to the state.

Nexus for Sales Tax Purposes

- "Nexus" is the requisite contact between an entity and a state before the state has jurisdiction to require the entity to collect tax.
- Pre-2018
  - Physical presence standard under *Quill* (1992).
- Post-2018
  - On June 21, 2018, the U.S. Supreme Court in *South Dakota v. Wayfair, Inc.* overturned *Quill's* "physical presence" requirement for sales tax nexus and allowed states to require tax collection from sellers with an '"economic" presence in their state (e.g., volume of sales into the state measured by sales revenue or the number of sale transactions over a certain time period).
  - Post-*Wayfair*, economic nexus standards have been adopted for every state with a sales tax.

Examples of Economic Nexus Thresholds

	Economic Nexus		
	Threshold	Enforcement Date	Citation
Alabama	$250,000	Oct. 1, 2018	Ala. Admin. Code r. 810-6-2-.90.03
Alaska	N/A	N/A	No state-level sales tax
Arizona	$150,000*; $100,000 in 2021 and beyond	Oct. 1, 2019	Ariz. Rev. Stat. Ann. §42-5043(A)(1)
Arkansas	$100,000 or 200 transactions	July 1, 2019	Ark. Code Ann. §26-52-111(a)
California	$500,000	April 1, 2019	Cal. Rev. & Tax. Code §6203(c)(4)(a)
Colorado	$100,000	June 1, 2019	Colo. Rev. Stat. §39-26-102(3)(c)(I)
Connecticut	$100,000 and 200 transactions*	Dec. 1, 2018	Conn. Gen. Stat. §12-407(a)(12)(G)
Delaware	N/A	N/A	No state-level sales tax
District of Columbia	$100,000 or 200 transactions	Jan. 1, 2019	D.C. Code Ann. §47-2001(w)
Florida	$100,000	July 1, 2021	Fla. Stat. §212.06(2)(c)
Georgia	$100,000 or 200 transactions*	Jan. 1, 2019	Ga. Code Ann. §48-8-2(8)(M.1)
Hawaii	$100,000 or 200 transactions	July 1, 2018	Haw. Rev. Stat. §237-2.5

Equity vs. Asset Deals

- Equity deals
  - Sales tax generally does not directly apply to equity transactions (i.e., stock or equity interests are intangible assets generally not subject to sales tax)
  - Direct liability concerns
    - Buyer will inherit the target's tax liabilities, including sales/use taxes
    - Highlights the importance of due diligence (income, non-income, and unclaimed property)
    - Understand target's footprint (where target previously filed/paid taxes may not be accurate, and buyer may need to register and start reporting/paying taxes in new judications post-closing)

Equity vs. Asset Deals

- Asset deals
  - Sales tax may directly apply to the transaction depending on the particular assets being purchased
    - Intangible assets (e.g., goodwill, intellectual property, trademarks) are generally not subject to sales tax
    - Tangible assets are generally subject to sales tax unless an exemption applies
  - Successor liability concerns
    - Generally, liabilities not specifically assumed by the buyer are retained by the seller
    - However, in many jurisdictions, certain tax liabilities (including sales taxes) attach to the assets of the target, and, in most situations, the buyer can become responsible for paying such liabilities

Assessing Taxability of an Asset Purchase

- Sales tax may apply to sales of assets, unless a specific exemption applies
- Primary exemption: occasional/isolated/casual sales tax exemptions
  - Not available in certain states (e.g., Colorado, New York, Oklahoma, and Wyoming)
  - Vary in scope; often only apply to TPP (not inventory or certain assets, e.g., vehicles – e.g., California and Pennsylvania).
  - Entire business requirement (e.g., Idaho) versus entire segment, division or branch of the business (e.g., Texas)
  - One buyer requirement/ambiguity in when rollover included in transaction? (e.g., Texas, all of the assets required to be sold "in a single transaction to a single purchaser")

Assessing Taxability of an Asset Purchase

- Other possible exemptions:
  - Sale for resale (inventory)
    - Practice tip: include a pre-closing deliverable in the purchase agreement for buyer to provide sale for resale exemption certificate to seller
      - Note: DREs respected for sales tax purposes and, thus, should be used on any exemption forms.
      - Note: For sale for resale exemptions, buyer generally must be registered as a dealer/retailer in the state.
  - Asset specific exemptions – e.g., motor vehicles, airplanes, manufacturing machinery and equipment
    - Practice tip : it is crucial to include an allocation schedule and separately list the assets in the purchase agreement (otherwise, treated as a bundle transaction and potentially fully taxable for sales tax purposes)

Avoiding Successor Liability in Asset Deals

- Bulk Sale / Tax Clearance
  - Most states require the buyer, the seller, or both parties to follow specific procedures (i.e., bulk sale procedures) when selling the assets of a business.
- Bulk sale may include:
  - providing notice to the relevant state tax authority of the transaction details;
  - requesting a tax clearance certificate; or
  - withholding money from the purchase price for any unpaid taxes
- Each state's laws are unique and the bulk-sale notification procedures can vary significantly from state to state.
- A key function of the bulk-sale procedures is to protect a buyer from inheriting any unpaid tax liabilities the seller.
  - Contractual protection via a specific tax indemnity will not limit a state tax authority's ability to hold a buyer liable under state law for seller's unpaid state taxes.

Avoiding Successor Liability in Asset Deals

- Jurisdictions at play– any jurisdiction where the business or assets are located
- Scope of successor liability varies by state and often goes beyond just sales taxes
- Timing considerations
- Practice tip:
  - Add pre-closing covenant for applicable tax clearance certificates (worthless if received after closing)
- If the bulk-sale procedures are not property followed or waived by the parties, the state is authorized to impose successor liability against Buyer for seller's unpaid sales taxes (typically limited to the purchase price, but not always, e.g., TX).
- Application to equity deals? Outlier – New Jersey
  - Corporate stock or membership interests owned by a business entity such as a corporation, LLC, LP etc. is a business asset of that business entity. Unless the business entity is in the ordinary course of buying and selling corporate stock or membership interests, the NJ Division of Tax must be notified.
  - Corporate stock and membership interests owned by individuals, estates or trusts are not considered business assets. Bulk sale notice is NOT required since the entity is not selling anything.

Asset & Equity Deals - VDA Programs

- A voluntary disclosure agreement (VDA) is a contractual agreement between the company and the state in which the company comes forward voluntarily to pay its tax obligations.
- Typically used in equity deals (often in combination with escrow).
  - Increased audit risk if Seller historically has not filed sales tax returns as Buyer will be required to register for sales tax purposes post-closing.
- VDA eligibility
  - Acceptance into a program will be contingent upon the fact pattern of the company's noncompliance.
    - Not previously contacted/audited by the state
    - No previous state tax registration (sales tax or otherwise?)
    - No fraud/intentional non-compliance

Asset & Equity Deals - VDA Programs

- VDA process
  - Submit anonymous letter or state application form to the taxing authority
  - Review records and self audit, which is subject to state review/negotiation
    - Complete spreadsheet (e.g., OH) or past tax returns for each applicable period (e.g., CA and NY)
  - Execute closing agreement
- VDA benefits
  - Limited lookback (e.g., usually 3-4 years)
  - Penalty abatement (interest is almost never abated, but varies by state)
  - Anonymity (ability to reject the state's offer)
- VDA risks
  - Failure to disclosure certain facts/activities may void VDA
  - Additional state tax liabilities may be uncovered during VDA process
    - Some states require the VDA to include all state taxes (not just sales and use taxes)

Asset & Equity Deals - VDA Programs

- Practice tips
  - Ensure eligibly prior to entering VDA
  - Practice tip:
    - Consider addressing the following in the VDA provision in purchase agreement:
      - Control
      - Consent to execute closing agreement
      - Timing (typically, 6 to 24 months to complete); delay in registration post-closing
      - Ability to contact or initiate collection actions against current/former customers
      - If the parties forgo VDAs, pay attention to post-closing restrictions regarding the ability to enter VDAs and filing of tax returns for pre-closing tax periods
      - Tax reps regarding eligibility for VDA

Recap of Drafting Considerations

- Transfer Tax Provision
- Bulk Sale Provision (generally only applicable in asset deals)
- Pre-Closing Deliverables/Requirements
- Tax Reps
- VDA Provisions/Prohibitions
- The Power Of The Allocation Schedule

Questions?

- Please feel free to reach out to me in the future if you have any sales tax or other SALT questions.