Tax Tidbits – August 2014

US State and Local Taxes – The states are not united

Many Canadian businesses find the opportunities to cross into and profit from the US market enticing. Before doing so, there are several things to consider such as whether to establish a branch office or US corporation, which US taxes will apply, and how products will be shipped. Often overlooked is the consideration of which state and local taxes ("SALT") will apply.

Where an entity is doing business in more than one country, tax treaties between the countries dictate which country is authorized to tax the income. These treaties are in place to reduce the potential for taxation of the same income in multiple countries. Generally these treaties only apply at the federal level and often do not apply at the US state level. The degree of aggressiveness to attribute income to their respective state varies by individual state and each one must be considered separately in order to determine the appropriate taxation. Even more disconcerting is the fact that some US cities also have their own taxation requirements.

The minimum connection allowing a state to impose its tax is known as "nexus" and is determined using several thresholds. The thresholds are discussed below and vary from state to state as well as by type of tax including income tax, franchise tax, and sales tax.

<u>State income tax</u>

If a company has nexus with a state, it will be responsible for filing a state income tax return and paying state income taxes for that state. If several states are involved, the US-sourced income will be allocated amongst the states based on sales, property and payroll in each state.

Physical presence qualifies for nexus in most states. Factors that create physical presence include:

- Maintaining inventory in a warehouse, or consigning to a customer;
- Employees soliciting sales or performing other functions;
- In-state contractors providing repairs, training, or services;
- Customers downloading software to their systems; and
- In-state providers directing web traffic to a business' website.

Many states[1] have ignored physical presence by adopting an 'economic nexus' or 'factor presence' standard whereby a taxpayer establishes nexus with a state by exceeding one of the following thresholds:

1. $50,000 of property;
2. $50,000 of payroll;
3. $50,000 sales; or
4. 25% of total property, total payroll, or total sales.

A US federal law[2] prohibits a state from imposing a net income tax if an entity's activities are limited to solicitation of sales of tangible personal property when the orders are approved and filled from outside the state. This law reduces the exposure to state income tax in the case of travelling salespeople as they may not create tax nexus even though they are soliciting orders in a given state. This law is limited in that it only applies to sale of goods not services, does not apply to non-US resident corporations, and only applies to state income taxes not sales or franchise taxes.

State franchise tax

Franchise taxes are based on the privilege of doing business in a particular state. The nexus-creating activities for franchise tax are similar to those for income tax; the main difference being that franchise tax does not necessarily respect the provisions of the US federal law mentioned above.

State sales tax

State sales taxes are similar to Canada's GST, PST, and HST which vary among provinces. Typically, there are minimum thresholds to overcome for isolated or casual sales. The ability to apply state sales taxes has historically followed the state's application of nexus for income taxes; however some states have strayed from nexus and require sales tax collection from remote sellers who have no physical presence in their state.

Identifying activity within a state

There are several ways a state can identify entities that are conducting business within their borders. State auditors research business connections by:

- Reviewing import logs from US customs to determine who is shipping items into the state;

[1] Multistate Tax Commission 2002 proposal
[2] Public Law 86-272

- Auditing in-state companies and identifying out-of-state invoices/vendors;
- Roaming trade shows and conferences to identify attendees; and
- Performing interdepartmental inquiries to identify other state licensing or registrations.

Some states require in-state customers to withhold tax from payments made to out-of-state residents for the portion of services actually performed within the state[3]. The vendors are identified for future follow-up once the withheld taxes are remitted to the state's taxation authority.

Many states are also sharing information with one another which has led to successive audits of non-US resident companies.

Voluntary disclosure

If an entity has been doing business in any number of states in which it is not registered for tax purposes, it should consider voluntarily disclosing its operations to the states in question. Some states allow the taxpayer to anonymously present their particular facts and enter into an agreement with the state which limits the period open to taxation (often to three or four years) and eliminates all penalties. Registering with a state prior to filing for a voluntary disclosure eliminates an entity's eligibility for the program, so the order that corrective action is taken is important.

If you are considering expanding business operations into the US or have already done so, please contact **Brent Hoshizaki** of Manning Elliott's US Tax Team for more information on the implications of SALT to your bottom line.

Registered charities and athletic associations – Action required!

The Canada Revenue Agency ("CRA") has recently announced that it requires all registered charities and registered Canadian amateur athletic associations ("RCAAAs") to apply for a certificate of continuance in order to maintain charitable status. Registered charities and RCAAAs, which are currently incorporated under the *Canada Corporations Act,* must transition to the new *Canada Not-for-profit Corporations Act* by filing a certificate of continuance by October 17, 2014. Failure to do so will result in dissolution of the organization and revocation of charitable status.

To learn more about the application process, please visit http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/nfpc/menu-eng.html or please contact **Wendy Seet** of Manning Elliott's Tax Team with any questions.

[3] Similar to the Canadian T4A-NR withholding tax requirement for payments to non-Canadian residents

And More…

- **Need a reminder for your business tax payments? There's an app for that!**

  Small and medium-sized businesses can now download a CRA mobile app to their iPhone, Android, or Blackberry. The app can be used to create custom reminders to help ensure that returns are filed and payments are made on time. For more information, go to: http://www.cra-arc.gc.ca/esrvc-srvce/mblpp/menu-eng.html

  Tech-savvy taxpayers can also connect with the CRA as follows:

  Follow the CRA on Twitter: @CanRevAgency [4]

  Subscribe to a CRA electronic mailing list [5]

  Add the CRA's RSS feeds to your feed reader [6]

  Watch tax-related videos on the CRA's YouTube Channel [7]

- **Sharing your CPP may result in tax savings**

  Although you cannot choose to split your CPP income with your spouse on your income tax return, you may be able to apply to Service Canada to share your pension with your current spouse or common-law partner. A successful application will result in the payments of CPP being split at source. For more information, go to: http://www.servicecanada.gc.ca/eng/services/pensions/cpp/retirement/sharing.shtml

  Sharing your CPP can result in tax savings where one spouse has significantly higher taxable income than the other spouse. To find out whether sharing your CPP would be beneficial, please contact **Tara Hauck** or **Lyndon Braun** of Manning Elliott's Tax Team.

[4] https://twitter.com/canrevagency

[5] http://www.cra-arc.gc.ca/esrvc-srvce/mllst/sbscrb-eng.html

[6] http://www.cra-arc.gc.ca/esrvc-srvce/rss/menu-eng.html

[7] https://www.youtube.com/user/CanRevAgency