

**COST 2015 Sales Tax Conference and Audit Session
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**Are you Paying Too Much Tax? –
Drafting Contracts To Minimize Taxes**

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Overview

- Why Does This Topic Matter?
 - Law books are filled with cases in which courts found a transaction taxable or not taxable because of the transaction documents
 - Sloppy transaction documents generally lead to bad results from a taxation perspective
 - Contracts not reviewed by a SALT professional can lead to bad results from a taxation standpoint
- What Types of Transactions Should We Worry About?
 - Day-to-day transactions
 - Partnership, joint venture and LLC operating agreements
 - Asset Sales
 - Sales of Interests in Entities
 - Internal Restructuring Transactions

Overview

- What Types of “Taxes” Do We Need to Consider When Reviewing Transaction Documents?
 - Sales and Use Taxes
 - Income/franchise taxes
 - Gross receipts, occupational license and business license fees and taxes
 - Transfer taxes
 - Employment taxes
 - Property taxes
 - Tax incentives
 - Not true taxes, but could be “buried treasure” or money left on the table
 - Unclaimed property
 - Not a true tax, but sometimes “acts” like a tax

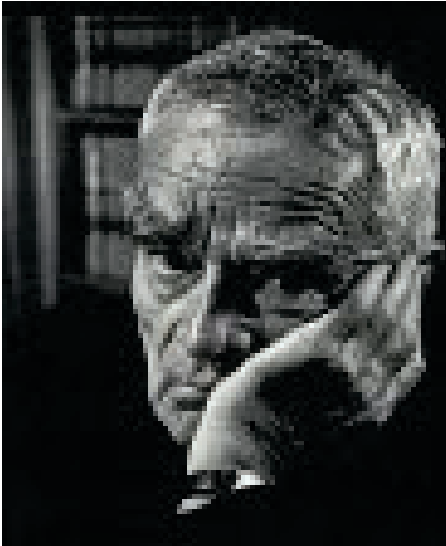
Overview

- What Types of Documents Should SALT Professional Review?
 - Day-to-Day Transactions
 - Contracts and Agreements
 - Master Service Agreements
 - Purchase/Work Orders
 - Invoices
 - Bills of Sale
 - Bills of Lading/Shipping Documents
 - Exemption Certificates
 - Master Agreements

Overview

- What Types of Documents Should SALT Professional Review? (continued)
 - Restructuring or Reorganization Transactions
 - Purchase Agreement (Asset or Entity)
 - Bills of Sale
 - Contribution Agreement
 - Entity Organizational and Operational Documents
 - Closing Documents (Including Exemption Documents)
 - Entity Formation and Operation Documents
 - Joint ventures, partnerships, LLCs

Fundamentals – A “Handy” Thought



- Judge Learned Hand wrote:
- “We agree with the Board and the taxpayer that a transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.” *Helvering v. Gregory*, 69 F.2d 809 (2nd Cir. 1934)
- Take Away: In structuring a transaction, it is permissible to structure the transaction in such a way as to minimize taxes within the bounds of the law

Fundamentals – Judicial Doctrines

- Do the Tax Implications of a Transaction Always Follow the Documents?
 - No, judicial doctrines come into play
 - Examples of Relevant Judicial Doctrines
 - Substance over form
 - Form over substance
 - Economic substance
 - Business purpose

Issues to Look for In Transaction Documents

- Sales/Use Taxes
 - Nexus
 - Taxability
 - Sale of TPP
 - Mixed Transactions
 - Purchase Price
 - Sourcing
 - Delivery terms
 - Local Tax Allocation
 - Responsibility for Collection/Remittance of Tax
 - Exclusions/Exemptions
 - Rates

Issues to Look for In Transaction Documents

- *Ticketmaster, LLC v. Commissioner of Revenue*, Minnesota Tax Court, No. 7866 (2008)
 - Ticket agent unsuccessfully argued that it was not the “seller” of tickets subject to sales/amusement tax
 - The party responsible for collecting and remitting the tax was the party furnishing the amusement services
 - Court relied on the fact that, by contract, the ticket agent was acting as exclusive agent for the venues to “sell” tickets on behalf of those venues

Issues to Look for In Transaction Documents

- Situs of Sale
 - If it is important, the PRACTICE TIP IS SIMPLE - put it clearly in the transaction documents
 - Tennessee Department of Revenue Notice: *Sales and Use Taxability of Goods Transferred to Carrier* (Oct. 2001)
 - Attempts to define where sale occurs
 - Focus on where buyer takes physical possession as shown in purchase documents
 - Default is location where “risk of loss” transfers

Issues to Look for In Transaction Documents

- Sales/Use Taxes – Sourcing
 - Examples of Delivery Terms to Consider
 - What is “FOB”?
 - “FREE ON BOARD”
 - Point at which seller’s obligation ends
 - On a Purchase Order/Bill of Lading or Invoice:
 - “FOB-Seller’s Dock”
 - “FOB-Buyer’s Dock”
 - “FOB-[Insert Location]”
 - Specificity is Important (Examples to Follow)
 - What about International Transactions and differing Shipping Terms for International Sales

Examples of What to Look For

3. **Freight Cost; Delivery** [REDACTED] will deliver the [REDACTED] Apparel Printer to the Purchaser at [REDACTED] principal place of business or ship to the Purchaser's designated address. All transportation and related insurance charges will be paid by the Purchaser. [REDACTED] shall not be liable for any failure or delay in furnishing the purchased products resulting from fire, explosion, flood, storm, widespread natural disaster, governmental acts, orders or regulations, hostilities, civil disturbance, strike, labor difficulties, machinery breakdown, transportation contingencies, difficulty in obtaining parts, supplies or shipping facilities or delay of carriers. Upon delivery, the Purchaser shall not sign carrier's POD (proof of delivery), without first examining and confirming that all items are delivered in good condition, free from any external damages. Purchaser should notify [REDACTED] of any external damages or missing items within 24 hours of receipt. Purchaser shall notify [REDACTED] of any damages and malfunction of the equipment within fourteen (14) days of receipt. [REDACTED] shall not be liable for any damage to the equipment if the Purchaser fails to examine the external damages before signing the POD, or the Purchaser fails to advise [REDACTED] of any damages in a timely manner. Purchaser is advised that the best way to protect his interest is timely communication and collaboration with [REDACTED] for any damages or malfunction of equipment.

4. **Installation and Training.** The Purchaser is responsible for installation of the [REDACTED] Apparel Printer and related equipment and accessories at its place of business. Purchaser will attend AnaJet training program for the proper use of the equipment. *TRAINING WILL TAKE PLACE AT PURCHASER'S LOCATION.*

5. **Title; Risk of Loss; Security Interest.** Title to the [REDACTED] Apparel Printer and related products shall pass to the Purchaser upon full payment for it being made to [REDACTED]. Risk of loss shall pass to the Purchaser upon delivery of products. Until full payment, [REDACTED] reserves title to all products sold hereunder as security for Purchaser's payment obligation. Should the Purchaser default in payment of any charges hereunder when due, [REDACTED] may remove and repossess the [REDACTED] Apparel Printer and related equipment and accessories sold by [REDACTED] with or without notice or demand, in addition to exercising such other rights and remedies as may be conferred on it by law. If the Purchaser fails to pay for the [REDACTED] Apparel Printer when due and [REDACTED] elects to repossess the products, [REDACTED] shall be entitled to all attorney's fees and costs of collection incurred by [REDACTED] in collecting such amounts or in repossessing [REDACTED] Apparel Printer and related equipment and accessories sold by [REDACTED] to the Purchaser.

Examples of What to Look For

KNOW ALL MEN BY THESE PRESENTS, that pursuant to the terms and conditions of the Agreement and for the consideration set forth therein, the receipt and sufficiency of which is hereby acknowledged, Seller hereby grants, conveys, sells, assigns, transfers and delivers to Buyer, its successors and assigns, in "AS-IS, WHERE IS" condition and without any express or implied warranties, all of Seller's right, title and interest in and to the Equipment, the Grant-Funded Equipment and the Supplies, as described and defined in the Agreement, to have and to hold same unto Buyer, its successors and assigns, forever.

Sourcing Sales

- Local Tax Allocation
 - In California, sales and use taxes are imposed at both the state and local level
 - For purposes of local sales/use taxes, the tax is allocated to a city based on a number of criteria, including whether the tax is a sales tax or a use tax
 - At the local level, taxpayers often enter into incentive agreements with cities providing for how the local sales tax is to be allocated
 - FOB terms are important in determining whether a transaction is subject to the sales tax or use tax

Sourcing Sales

“Title to Products and risk of loss or damage during shipment pass from Seller to Customer upon deliver to the destination specified on the applicable Purchase Order (F.O.B. Origin, freight prepaid).

Notwithstanding the foregoing, in the case where Customer provides its carrier account number to Seller or Customer selects a carrier that does not ship regularly for Seller, title and risk of loss pass from Seller to Customer upon delivery by Seller to the carrier (F.O.B. Origin, freight collect).”

Sourcing Sales

- *Lowe's Home Center, Inc. v. Kennedy*, 744 So.2d 711 (La. App. 2nd Cir. 1999)
 - Goods (store fixtures) purchased from N.J. vendor
 - Contract provides for “FOB-Seller’s Dock”
 - Goods delivered by common carrier to Louisiana
 - N.J. sales tax paid to vendor
 - La. assesses use tax on goods
 - Taxpayer claimed credit for taxes paid to N.J.
 - Who wins?
 - Court holds that taxes were properly paid to N.J. because seller’s obligations ended at its dock
 - Contract carrier was agent of taxpayer
 - Taxpayer was entitled to credit

Sourcing Sales

- *Leggett & Platt, Inc. v. Ostrom*, 09-CA-1322 (Co. Ct. App. Div. V 9/30/10)
 - Similar facts to *Lowe's*, except taxpayer had goods picked up and delivered by a common carrier
 - Court focused on invoices and bills of lading, which provided “F.O.B.-Shipping Point” (i.e., seller’s dock)
 - Court found sales tax was due at seller’s location even though shipped via common carrier out of City

Sourcing Sales

- *J. Ray McDermott, Inc. v. Morrison*, 705 So. 2d 195 (La. App. 1st Cir. 1997)
 - Texas vendor sells goods that are shipped to taxpayer/purchaser via common carrier
 - Taxpayer's facility located on island in Sabine River between Texas and Louisiana
 - Administrative Offices in Texas
 - Fabrication yard on island in Louisiana (only access is via a bridge from Texas)
 - Invoices list Texas address, but goods delivered to and used in Louisiana facility
 - Taxes paid to Texas vendors

The Visual



Sourcing Sales

- *J. Ray McDermott, Inc. v. Morrison*, 705 So. 2d 195 (La. App. 1st Cir. 1997)
 - Result: taxpayer not entitled to credit for Texas sales tax; double tax
 - What could have been done to avoid the problem?
 - Understand the Company's facts
 - Change the terms of the purchase documents
 - Educate your businesses regarding sales tax basics (e.g., importance of shipping terms)

Sourcing Sales

- Situs of Lease Transactions
 - Some states tax leases based on where the lease is entered into
 - *Williams Rentals, Inc. v. Tidwell*, 516 S.W. 2d 614 (Tenn. 1974)
 - Some states tax leases based on where the leased property is located at the time the lease payment is made
 - Kansas (103 KAR 28:051)
 - New Jersey (NJSA 54:32b-7(c) – (d))
 - Indiana (Information Bulletin 28L (July 2007))
 - Wisconsin (WI Sales and Use Tax Information, Publication 201, pg. 69)

Issues to Look for In Transaction Documents

- Sales/Use Taxes – General Guidelines
 - If a transaction includes some taxable transactions and some non-taxable transactions, address them separately in all of your transaction documents
 - Allocate “sale price” between taxable and non-taxable elements of the transaction

Issues to Look for In Transaction Documents

- Sales/Use Taxes – Taxability
 - Taxable v. non-taxable services
 - *Penske Truck Leasing Co. v. Huddleston*, 795 S.W. 2d 669 (Tenn. 1990) (Optional gasoline charges did not constitute additional rents)
 - Single Article Cap
 - *Honeywell Information Systems, Inc. v. King*, 640 S.W.2d. 553 (Tenn. 1982)
 - Considering International Sales and VAT consequences of taxable and nontaxable items
- Rates
 - Special rates may apply to certain types of transactions or property
 - Separately state in transaction documents
- International Transactions: Consideration of whether VAT is due and issuing invoices for VAT

Issues to Look for In Transaction Documents

- Tangible v. Intangible Property
 - *Navistar International Transportation Corporation v. State Board of Equalization*, 8 Cal. 4th 868 (1994)
 - Transfer of trade secrets in the form of drawings and designs, manuals and procedures and computer programs were taxable sales of tangible personal property
 - Pay special attention to transactions involving computer software, digital goods and services, and cloud computing

Examples of What to Look For

2. Scope of Services. Consultant shall perform its duties and responsibilities under this Master Agreement (i) in conformity with the standards of care and skill demonstrated by professionals providing the services similar to the Consultant Services, (ii) in a manner that is in the best interests of Client, and (iii) in strict accordance with the terms and requirements of any Project Order, including, but not limited to, the timeline for performance of the Consultant Services. Consultant shall complete the Consultant Services in a professional, efficient, and diligent manner. Consultant shall not have authority to bind Client or incur any liabilities on behalf of Client. All reports, plans, drawings, specifications and other materials prepared by or under the supervision of Consultant in connection with the performance of the Consultant Services (collectively, the “Plans”) will comply with all applicable governmental laws, rules, regulations, codes, ordinances, judgments and decrees. The parties acknowledge and agree to that the Consultant Services on any Project may be reduced prior to the completion of Consultant Services. In the event of such reduction, Client shall have the right in its sole and absolute discretion, to either terminate this Master Agreement as provided herein or to negotiate with Consultant for proportionate revisions to this Master

Examples of What to Look For

5.3. **Deliverables.** [REDACTED] shall deliver the Deliverable(s) to Customer in accordance with the applicable Statement of Work. Each Statement of Work shall set forth a period after delivery of a Deliverable (the "Acceptance Period") for the performance of acceptance or functionality testing, if any, and the period within which Customer shall provide [REDACTED] with a notice of any non-conformities. If not specified in the applicable Statement of Work, the Acceptance Period is deemed to be fourteen (14) days after delivery of the Deliverable. If the relevant Statement of Work is priced on a Fixed Price Basis, then, unless otherwise provided, [REDACTED] shall correct all material non-conformities within thirty (30) days of receipt of such notification. Failure to correct the material non-conformance during such period may be deemed by Customer to be a material breach of the SOW. If the relevant Statement of Work is priced on a Time and Materials Basis, then, unless otherwise provided, the Parties shall follow the modification procedures set forth in Section 4.2. Customer is deemed to accept a Deliverable when it either (a) provides [REDACTED] with written notification of acceptance or (b) fails to provide such written notice to [REDACTED] within the Acceptance Period.

Examples of What to Look For

Hours	Description	Rate	Amount
90	SAP Consulting Services - 09/05/10 - 09/18/10 - VA	170.00	15,300.00
	Expenses - 09/05/10 - 09/18/10	465.00	465.00

Not Uncommon for terms such as software design and development to appear on this type of invoice.

Actual character of transaction may depend on master service agreement and statement of work/work order

Where to Look in Transactions Documents

- Look at Entire Document
 - Make sure it is the executed version with any and all amendments, attachments and exhibits
- Tax Specific Sections
 - Definitions
 - Nature of transaction
 - Delivery terms
 - Payment terms
 - Terms Affecting Exclusions/Exemptions
 - Terms Affecting Incentives

Examples of What to Look For

A. SERVICES: Contractor agrees to perform for [REDACTED] the services (the "Services") and produce the corresponding deliverables ("Deliverables") provided for herein which are set forth with greater particularity in Exhibit A annexed hereto (or other similar documents, each a "Statement of Work"), the Master Timeline and Cost Estimate ("MTCE") annexed hereto as Exhibit B and each of the Statements of Work which become annexed hereto from time-to-time as Exhibit C, each of which Exhibits are hereby made a part hereof and collectively describe the Services. The Contractor shall be fully licensed, certified and bonded as customary or required by applicable law, from time to time, subject to and in accordance with the STANDARD TERMS AND CONDITIONS hereof which are hereby specifically incorporated herein.

B. PRICE: See Exhibit A attached hereto.

C. TERM: See the STANDARD TERMS AND CONDITIONS attached hereto.

Issues to Look for In Transaction Documents

- Sales/Use Taxes - Additional Issues
 - Are the goods taxable where they will be delivered and used?
 - Exclusions/Exemptions
 - Special rates may apply to property or taxpayer
 - What are the additional costs of altering transaction documents?
 - Delivery costs
 - Nexus issues
 - Other business considerations
 - Who is responsible for taxes?

Examples of What to Look For

17. Taxes. Consultant shall, in a timely manner, at its own expense complete and submit to the appropriate governmental authorities all required tax reports and returns and shall pay all sales, use and personal property taxes and all other taxes assessed or levied in connection with the services.

4.4 Taxes. Contractor shall invoice the Company and the Company shall reimburse Contractor for any taxes actually paid by Contractor which are imposed upon Contractor by any governmental agency as a result of this Agreement with the exception of taxes based on Contractor's income, status (such as governmental licenses to perform the Services), and equity.

18. TAXES: To the extent that [REDACTED] is advised of taxes in a Statement of Work, [REDACTED] shall pay for all taxes to the extent quoted in a Statement of Work.

Issues to Look for In Transaction Documents

- Sales/Use Taxes - Exclusions/Exemptions
 - If necessary, include appropriate language in transaction documents to address available exclusions or exemptions
 - Manage exclusion/exemption certificates

Closing Thoughts Regarding Value Added Taxes

- VAT legislation generally covers what might otherwise be included in the agreement
 - Particularly, whether the transaction is subject to VAT
- Generally, parties agree who bears the cost of VAT (usually party paying the consideration), whether the VAT is included in the sales price, is VAT due separately, etc.
- VAT is intended to be neutral for most businesses
 - If buyer is liable for VAT, it will generally be able to reclaim that VAT from the taxing authority
 - Exceptions for certain industries (e.g., financial services, health and education)

Closing Thoughts Regarding Value Added Taxes

- Exemption from VAT for a transfer of a going concern
 - Specific language required in the agreement
 - Taxing authority may challenge whether transaction involves transfer of going concern
 - Include provisions to deal with the possibility of a challenge by the taxing authority as to whether going concern is being sold
- No VAT on sales of stock in company
 - No requirement of language in agreement with respect to VAT

Best Practices for Day-to-Day Transactions

- Understand Transactions
- Understand Transaction Documents
- Be Specific and Clear in Transaction Documents
- Retain Executed Versions of Transaction Documents (with all attachments and exhibits)
- All Amendments to Transaction Documents in Writing
- Address Responsibility for Taxes in Transaction Documents
- Strictly Adhere to Terms and Conditions of Transaction Documents
- Understand Customer Base
 - retail, wholesale, manufacturing, R&D, government
- Understand Nexus Issues
- Manage Exclusion/Exemption Documentation
- Develop Tax Matrix
- Establish and Maintain Good Contacts in Business Units
- Constantly Review Transactions and Transaction Documents
- Review Tax Provisions

Questions?