Legacy ADVISORS GROUP

M & A UPDATE®

July 2009 Volume 5, Issue 7

Technology: The Internet and Sales Tax

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Introduction

In the past, assessment and submission of state sales taxes was easy. Merchants would add on the required state sales tax to the purchase, that amount would be collected, and the merchant would submit the required amount to the appropriate governmental authority. This was the case until cars and the telephone were invented. The laws then advanced to address the technology. It then took tax professionals a while to catch up with the rules, but the adjustment was made.

Once again, the governing bodies and professionals now find themselves with another proliferation of technology, i.e. the Internet. The Internet has had the effect of transforming a simple tax into a very complex tax. It is important for merchants to understand the nature and requirements this added technology and the new rules place on the sales tax. State sales taxes can add substantially; not only to the invoice a customer pays, but also an incredible level of confusion. Now merchants must not only calculate sales taxes based on their state laws, but also, add taxes based on different states tax rules, depending on the connection and location of the buyer.

The problem? State sales tax rates and rules vary widely. Some states have no sales taxes, while others have combined state, county, and local taxes adding up to about 10%. As a rule, industrial states, such as New York and California, have higher sales taxes than a lot of other states. In order for a merchant to properly assess and collect sales taxes today, the merchant must now understand not only the connection required, but various states' sales tax rates and rules as well.

The Connection or "Nexus" Rules

In order for a sales tax to be assessed, a connection to the state must exist with the selling company. This used to be a simple test. It is no longer simple. An analysis of key court cases reveals the following:

1. The *Quill* Case illustrated that if the seller has a physical presence within the state, there is sufficient connection for the merchant

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A CASE STUDY

The Tax Court ruled that a minority interest discount and lack of marketability discount applied to the valuation of a family limited partnership (FLP) interest. In the case, the decedent, daughter, and son-in law formed an FLP and a limited liability company (LLC). When the decedent died, he owned a majority interest in the FLP and a one-third interest in the LLC. The estate hired a valuation expert to appraise the estate and FLP. The expert applied a 53% discount based on several factors such as minority interest and lack of marketability. The IRS disputed the large discounts and assessed a deficiency against the estate of a net discount of 25%. In usual fashion, the Tax Court ruled a net discount of 35.5% was appropriate, reflecting minority shareholder status and lack of marketability.

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Cover Story

to collect a sales tax for that state.

2. The Supreme Court then ruled in the *International Shoe* case that "minimum contacts" is sufficient to impose a sales tax on the selling company.

3. In *Hanson v. Deckla*, the Supreme Court ruled "purposeful availment" (which is a lesser degree of contact than "minimum contacts") was sufficient to impose a sales tax for the sale.

4. In *Calder v. Jones*, the rule was further eroded when the sale of a magazine in a state was found to be sufficient nexus or connection for the merchant to be responsible to collect and pay the state sales tax.

In short, although the rule behind the *Quill* case has been all but eliminated, the constitutional rules of fairness and reasonableness still apply. If a merchant can not reasonably foresee or it would be fundamentally unfair to assess a tax on a seller, the tax will be held to be an impermissible reach of a state's jurisdiction into another.

New Legislation

Though case determination has largely defined the rules in the past, state legislators are once again making rules to increase their revenue. In what are dubbed "Amazon Laws," named after Amazon.com, several states are passing laws requiring internet based businesses which have very minimal contacts with particular states to collect and submit sales taxes to governing authorities for all sales made over the Internet to addresses in their states. Under these new rules, a possibility exists for some website based companies to be subject to the jurisdiction of 7,500 taxing bodies. This is certainly a challenge for most sellers. The states that currently have or are developing Amazon Laws include Tennessee, New York, Minnesota, Connecticut, and Hawaii.

Conclusion

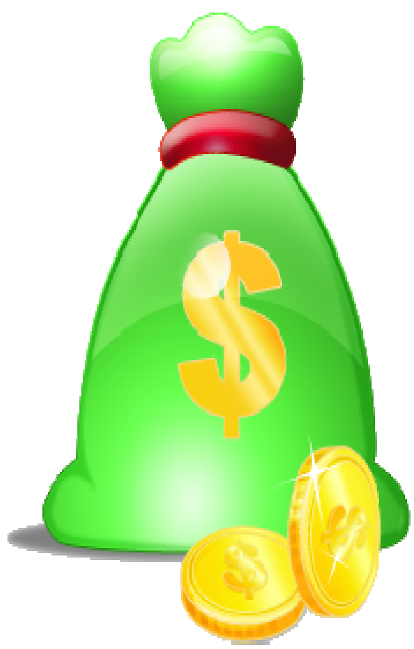
Business owners and accountants now are in need of knowing sales tax rules in multiple states, even if their company has no or little physical presence in a state, but the company sells in the state. The "Amazon Law" has survived scrutiny by at least one court in the State of New York and presumably will survive more. If your business is in the business of selling via the Internet, you must keep abreast of these rules. Contact The Center if you have any concerns or questions in these matters.

Dr. Bart A. Basi is an attorney, CPA, and the Senior Advisor of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes. Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the Financial, Legal & Tax Advisory which may be read in various industry-specific trade publications.

A CASE STUDY CONTINUED:

Editor's Comment: The Tax Court is filled with truly intelligent and well educated men of tax law. Yet, it never ceases to amaze me how many of these cases end in a result which is essentially the mathematical mean between the estate's discount and the IRS's discount plus or minus a few points.

FLP vehicles are appropriate for estate planning in limited situations; however, most situations are such in nature that other planning instruments lead to better results. Business sales, for one, to children lead to fool-proof results most of the time. In FLP planning, the value and discounts are subject to challenge and audit which are usually avoided in sales to children or heirs.



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Points of Interest

- Once again, the governing bodies and professionals now find themselves with another proliferation of technology, i.e. the Internet.
- State sales tax rates and rules vary widely. Some states have no sales taxes, while others have combined state, county, and local taxes adding up to about 10%.
- . . . several states are passing laws requiring Internet based businesses that have very minimal contacts with particular states to collect and submit sales taxes . . .

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WOULD YOUR COMPANY BE A GOOD CANDIDATE FOR AN ESOP?

Mike Ertel, CBI/ M&AMI/ CM&AA

Employee Stock Ownership Plans (ESOP) have been around for 35 years, and many well known, national companies have them, but many misconceptions still exist, such as: (1) Employees will directly own the company's stock [FALSE], or (2) Employees will directly ratify everything from executive compensation to capital spending plans [FALSE], or (3) Employees will have complete access to all of the company's trade secrets and financial data [FALSE].

Employee Stock Ownership Plans (ESOP) have been around for 35 years. Today, there are over 10,000+ ESOP's in the US covering 10.5 million employees (10% of the US private workforce). Total assets owned by ESOP companies is approximately $675 billion. Well-known examples of ESOP companies include Proctor & Gamble, Anheuser Busch, Sherman Williams, United Airlines, and Publix.

Selling to an ESOP trust can have many advantages for the Seller, including: (1) ESOP sales are stock sales, and qualify for lower CAPITAL GAINS tax rates, (2) Sellers may reinvest 100% of the proceeds TAX DEFERRED, (3) Sellers may sell from 30% up to 100% of their shares, and still retain 100% operating control of the company, and (4) By creating an ESOP the business owner creates a built-in stock buyer for the balance of the company when the time comes to sell the balance of his/her interest. In some cases, Sellers may receive a substantially higher price from an ESOP, depending upon the specifics and existing market conditions.

ESOP's are viable for manufacturing, distribution and some service companies with: ---Single digit to moderate growth rates
--Stable, tenured workforce
--Substantial debt capacity
--Steady, positive cash flows
--Exiting shareholders wanting to gradually exit over a few years
--Exiting shareholders wanting control and confidentiality
--Exiting shareholders wanting to benefit managers and employees

ESOP's may not appropriate for:
--Companies in decline
--Companies with negative, or unpredictable cash flows
--Very high growth companies
--Exiting shareholders wanting to immediately sever all ties with the company

Legacy Advisors Group has experience working with ESOP financial advisors, bankers, attorneys, appraisers, etc., and can help you decide if an ESOP is right for your company. To learn more about ESOPs and qualify for a FREE, preliminary feasibility study, contact me at mertel@legacyadvisorsgroup.com

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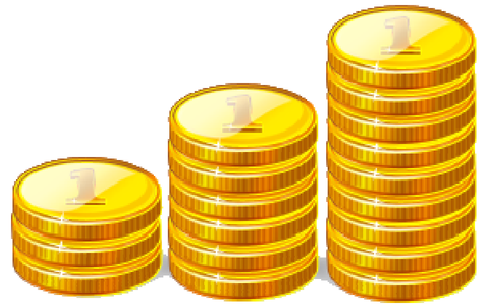

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Frequently Asked Questions…

Q: I am finishing my personal tax returns. Can I split my tax refund and send it to different institutions?

A: Absolutely. In what is known as a "split refund" a taxpayer can direct the IRS to pay up to three United States financial institutions.

Q: We hear a lot in the news regarding the health care legislation concerning taxation of benefits and requirements to purchase health insurance for employees or ourselves. Has anything been finalized yet?

A: No. So far, President Obama and Congress have not come to any final decisions or even a draft of the health care bill (law) they intend to enact. Although the speculation on the subject is rampant, taxpayers and business people should keep in mind that the political process that writes the bills is often not indicative of the final law. President Obama and Congress realize that the voters must be content with whatever The President and Congress produce, or else they risk the possibility of being elected out. Business owners should not act on any speculation currently going through Congress, but should instead wait to see what the situation is once the bill arrives for signature on President Obama's desk.

Q: Can you give some general advice regarding what individual taxpayers can do in order to lessen their federal tax burden?

A: My first advice would be to fund qualified pensions. Most of the proceeds given to pensions are not only tax deferred, but protected form lawsuits and, depending on your plan, may be matched by employer matching contributions. Second, purchasing a home usually qualifies individuals for itemized deductions, lessening their tax burden even further.