

# STATE+LOCAL TAX INSIGHTS

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## IMPORTANT SALT CONSIDERATIONS IN M&A: ARE YOU EXPOSED FOR SALT?

By [Mitchell A. Newmark](#) and [Eugene J. Gibilaro](#)

Right now, we are seeing a lot of deal activity. 2018 was the third busiest year *ever* for mergers and acquisitions (“M&A”), with more than \$3.8 trillion in announced deals.<sup>1</sup> While worldwide deal-making is down somewhat overall so far in 2019, deal volume is up 2% from the same period last year in North America, with approximately \$470 billion of announced deals in the first quarter.<sup>2</sup> While the deal market remains hot, the non-state and local tax (“SALT”) folks running the deals at your company may not be aware of the various potential SALT issues that need to be considered. It is critical that they be made aware of the importance of involving SALT people early and often. With that in mind, we review some often overlooked but important SALT considerations that need to be addressed when your company is buying, selling or restructuring.

# Upcoming Speaking Engagements

## May 15, 2019

### **STARTUP Spring Conference**

New York, New York

- “State of the States Update”  
Craig B. Fields and Nicole L. Johnson

## May 15 – 16, 2019

### **Georgetown University Law Center, 2019 Advanced State and Local Tax Institute**

Washington, D.C.

- “Alternative Apportionment”  
Craig B. Fields
- “State Tax Conformity with Federal Tax Reform: What Does the State Tax Landscape Look Like 18 Months after the TCJA?”  
Mitchell A. Newmark

## May 22, 2019

### **Energy Tax Association: 28th Annual Meeting**

New York, New York

- “Significant Developments in State and Local Taxation”  
Craig B. Fields and Nicole L. Johnson

## June 1, 2019

### **New York State Bar Association Tax Section Spring Meeting – Harwich**

Cape Cod, Massachusetts

- “New York Taxation of GILTI”  
Irwin M. Slomka

## June 4, 2019

### **Council On State Taxation/OFII, 2019 U.S. Forum on State and Local Taxes for European Companies**

London, UK

- “U.S. Federal Tax Reform and What It Means for the States?”  
Mitchell A. Newmark
- “State Taxes – Constitutional Limitations on the State’s Jurisdiction to Tax Businesses and Certain Types of Business Income”  
Mitchell A. Newmark

## June 20, 2019

### **California Lawyers Association Webinar**

- “California Sales and Use Tax Issues for Nonprofit Organizations”  
William H. Gorrod

## July 24, 2019

### **S.F. Quarterly SALT Update**

San Francisco, California

- William H. Gorrod

## July 26, 2019

### **New York University’s July Tax Conferences, Advanced Subchapter S**

New York, New York

- “State Income Taxation of S Corporations”  
Mitchell A. Newmark and Eugene J. Gibilaro

## October 28 – 30, 2019

### **Vanderbilt University Law School’s 26th Annual Paul J. Hartman State and Local Tax Forum**

Nashville, Tennessee

- “Top Ten Income Tax Cases”  
Hollis L. Hyans
- “To Be Or Not To Be – Judicial Deference in State Tax Controversies”  
Craig B. Fields
- “Local Taxes and Other Unwelcome and Unexpected Taxes”  
Mitchell A. Newmark

## November 5, 2019

### **San Francisco Tax Club**

San Francisco, California

- William H. Gorrod

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## SUCCESSOR LIABILITY

When the stock of a corporation is acquired, the corporation will generally continue to be liable for its previously existing tax liabilities. Therefore, stock-deal buyers generally ensure that appropriate language is included in the purchase agreement to protect against buying unknown or concealed liabilities. The unwise think asset deals leave them with no worries.

It is equally important for an asset buyer to protect itself against the historic SALT liabilities of a target. Note that buyers of partnership and LLC interests are deemed asset buyers for federal income tax purposes.<sup>3</sup> Moreover, for asset deals, states do not typically follow the federal income tax rule that there is no successor liability for a buyer unless the transfer constituted a fraudulent conveyance under state law.<sup>4</sup> State successor liability statutes typically apply more broadly, do not require a fraudulent conveyance in order for successor liability to apply and may apply to more taxes than just sales and use taxes. State liabilities can be for all taxes.<sup>5</sup> Just because you found the sales and use tax bulk sale law does not mean that you found all the tax bulk sale laws in the state. The laws can be contained in other tax statutes.<sup>6</sup>

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**Just because you found the sales and use tax bulk sale law does not mean that you found all the tax bulk sale laws in the state.**

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The majority of states have bulk sales laws that require a purchaser of assets to follow notice and withholding requirements. For example, in New York, a purchaser must notify the Department of Taxation and Finance (the “Department”) of a pending purchase of business assets from a person required to collect sales tax at least 10 days before the purchase.<sup>7</sup> Within 5 business days after receiving notice, the Department will issue either: (a) a release if the seller does not have any unpaid sales taxes and an additional review or audit is not necessary; or (b) a claim if the seller owes unpaid sales tax, is scheduled for a review or is under audit. A purchaser that receives a claim from the Department must place the full amount of the purchase price in an escrow account or become liable for the amount of the claim. The Department will alert the purchaser to the amount of sales tax due within 90 days of receiving notice of the sale and the purchaser must pay the amount due out of the escrow account. If the purchaser fails to comply, then it is liable up to the amount of the purchase price. However, the purchase-price cap is not universal and, in some states, the purchaser can assume liabilities *in excess of* the purchase price of the assets.<sup>8</sup>

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**In some states, the purchaser can assume liabilities *in excess of* the purchase price of the assets.**

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Finally, compliance with the bulk sales requirements contained in a state’s enactment of the Uniform

Commercial Code (“UCC”) is *not* the same as compliance with the state’s bulk sales requirements for tax purposes. For example, under California’s enactment of the UCC, a purchaser is only required to withhold for a seller’s outstanding liabilities in asset deals where the purchase price is \$2 million or less and no UCC bulk sales requirements apply at all if the value of the assets sold exceeds \$5 million.<sup>9</sup> However, neither of these limitations applies with respect to California’s tax bulk sales requirements for sales tax purposes. A purchaser will be liable for the seller’s historic sales tax liabilities if it fails to comply with California’s tax bulk sale requirements regardless of the purchase price or value of the assets.<sup>10</sup>

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**Compliance with the bulk sales requirements contained in a state’s enactment of the Uniform Commercial Code is not the same as compliance with the state’s bulk sales requirements for tax purposes.**

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## INCOME TAX CONSIDERATIONS

While federal income tax practitioners are often brought in early in the deal process to evaluate the federal income tax consequences of the deal’s proposed structure, state tax practitioners often are not. This is a value loss to the company because, while states often follow the federal result for income tax purposes, this is not always the case. For example, in a spin-off or restructuring, if Company A distributes its subsidiary’s stock with an appreciated value to its parent, then Company A will have gain for federal income tax purposes.<sup>11</sup> However, Company A’s gain is deferred if the companies are members of the same federal consolidated tax group.<sup>12</sup> The answer, however, is tricky for states that require separate company reporting, states for which the combined filing group is different from the federal consolidated group and states that do not follow the specific federal consolidated return regulations.

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**In taxable transactions, there will always be apportionment considerations that are unique to SALT.**

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Moreover, in taxable transactions, there will always be apportionment considerations that are unique to SALT. These considerations include whether the gain from the sale of a business is apportionable under the U.S. Constitution and, if so, whether the gain is required to be apportioned under the apportionment law in each

state. For constitutional purposes, the analysis focuses on whether the business sold was part of the seller's overall unitary business.<sup>13</sup> When analyzing the sale of assets, we ask whether the asset was used in the operation of the business.<sup>14</sup>

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## **SALT-specific considerations arise in acquisitions in which the parties elect for the transaction to be deemed an asset sale for federal income tax purposes pursuant to Internal Revenue Code Section 338(h)(10).**

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For state law purposes, the analysis typically focuses on whether the gain constitutes business income that should be apportioned or nonbusiness/non-operational income that should not be apportioned under the state's specific definitions of those terms. Cases in this area focus on whether selling a business or a business segment is an integral part of the seller's overall business such that requiring apportionment of the gain from that sale is appropriate.

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## **In California, the parties can elect out of a federal Section 338(h)(10) election or, conversely, elect a California-specific Section 338(h)(10) election in the absence of a corresponding federal election.**

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Other SALT-specific considerations arise in acquisitions in which the parties elect for the transaction to be deemed an asset sale for federal income tax purposes pursuant to Internal Revenue Code ("I.R.C.") Section 338(h)(10) ("Section 338(h)(10)"). While many states follow the federal treatment of Section 338(h)(10) elections through their conformity with the I.R.C., there are a number of state-specific quirks to consider. For example, in California, the parties can elect out of a federal Section 338(h)(10) election or, conversely, elect a California-specific Section 338(h)(10) election in the absence of a corresponding federal election.<sup>16</sup> Moreover, there is typically no mechanism that allows the target's gain from the deemed sale of assets in a Section 338(h)(10) transaction to be transferred to its parent in states that require separate company reporting.<sup>17</sup> A potential solution could be to reduce the purchase price or make some similar financial adjustment between the parties though, to be clear, such an adjustment would only resolve the economics between the parties and would not likely affect the party from which the state can collect the tax.

## **NON-INCOME TAX CONSIDERATIONS**

### **A. SALES AND USE TAX**

Sales tax should not apply in deals where the purchaser acquires the stock of the target for consideration because what is being purchased is an intangible interest and sales of intangibles are traditionally not subject to sales tax (this result is pure legislative grace). However, sales tax could potentially apply in any type of deal where there is a transfer of taxable assets for consideration. Moreover, given the broad definitions of "sales" in most states, sales tax will likely apply unless a specific exemption exists for the transaction. These exemptions are typically drafted narrowly and must be strictly complied with in order to apply inasmuch as sales tax rules generally follow form over substance.

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## **Sales tax could potentially apply in any type of deal where there is a transfer of taxable assets for consideration.**

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For example, in New Jersey, a sales tax exemption applies for "[t]he transfer of tangible personal property to a corporation, solely in consideration for the issuance of *its stock*, pursuant to a merger or consolidation effected under the laws of New Jersey or any other jurisdiction."<sup>18</sup> However, what if the transfer of the taxable assets is solely in consideration for the issuance of the stock of the acquiring corporation's *parent*? While this factual variation may not be consequential for federal or state income tax purposes, here it would result in the loss of the New Jersey sales tax exemption. This is just one example of the kinds of issues that may be missed unless SALT people are involved.

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## **Some states impose controlling-interest transfer taxes even when the transfer results in no change in the ultimate beneficial ownership of the real property.**

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### **B. REAL ESTATE TRANSFER TAXES**

More than a dozen states impose their real estate transfer taxes when a controlling interest in an entity that owns real property is transferred.<sup>19</sup> Therefore, these controlling-interest transfer taxes ("CITT") could potentially apply to stock deals depending on where the target's real property is located. Moreover, some states will look through multiple tiers of subsidiaries to an ultimate change in ownership at the parent-level for purposes of imposing CITT.<sup>20</sup> In these states,

CITT could potentially apply even if the target does not directly own real property, but owns interests in other entities that own real property. Conversely, some states impose CITT even when the transfer results in no change in the ultimate beneficial ownership of the real property.<sup>21</sup> In these states, a corporate restructuring could potentially trigger the tax.

### C. UNCLAIMED PROPERTY

Unclaimed property (for example, uncashed payroll checks, uncashed payable disbursements and negative receivables), though not a tax, is typically an area that is left to SALT people to think about during deals. A tax indemnity provision in a stock purchase agreement may not include unclaimed property liabilities because unclaimed property is not a tax – it is an obligation to remit abandoned property to a state. For an asset deal, a negative account receivable may be part of the purchase. Unfortunately, this is not free money for the buyer. It is a potential liability to be reported and remitted if the applicable dormancy period has passed.

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## Companies that are not including SALT people on their deal teams may be exposing themselves to unnecessary risks.

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### CONCLUSION

The above is just a sample of the multitude of SALT issues that could potentially arise during a deal. With the deal market as hot as it is right now, companies that are not including SALT people on their deal teams may be exposing themselves to unnecessary risks and potentially missing out on significant opportunities. For those companies, the time is now to start staffing SALT people on their deal teams.

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1 Dana Mattioli et. al., *A Big Year for Deals – and Deal Makers*, WALL ST. J. (Dec. 30, 2018, 6:17 PM), <https://www.wsj.com/articles/a-big-year-for-dealsand-deal-makers-11546185622>.

2 Cara Lombardo & Ben Dummett, *Global Deal-Making Gets Off to a Slow Start in 2019*, WALL ST. J. (Mar. 30, 2019, 7:00 AM), <https://www.wsj.com/articles/global-deal-making-gets-off-to-a-slow-start-in-2019-11553943601?mod=searchresults&page=1&pos=3>.

3 *McCauslen v. Comm'r*, 45 T.C. 588, 592 (T.C. 1966).

4 *Diebold Found., Inc. v. Comm'r*, 736 F.3d 172, 184 (2d Cir. 2013).

5 *See, e.g.*, N.J. Stat. Ann. § 54:50-38.

6 For example, Illinois' bulk sales law for sales and use tax can be found in the Retailers' Occupation Tax Act (35 Ill. Comp. Stat. 120/1-120/14). However, Illinois' bulk sales law for income tax is found in Article 9 of the Illinois Income Tax Act (35 Ill. Comp. Stat. 5/901-5/918).

7 N.Y. Tax Law § 1141(c).

8 *See, e.g., Bunting v. Dir., Div. of Taxation*, 1 N.J. Tax 189, 197 (Tax Ct. 1980).

9 Cal. U. Com. Code §§ 6101-6999.

10 Cal. Rev. & Tax. Code §§ 6811-6815.

11 I.R.C. § 311(b).

12 Treas. Reg. § 1.1502-13.

13 *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 25 (2008).

14 *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 787 (1992).

15 *See, e.g., Jim Beam Brands Co. v. Franchise Tax Bd.*, 34 Cal. Rptr. 3d 874 (Ct. App. 2005), *review denied*, No. S139031 (Cal. Jan. 4, 2006); *Lenox, Inc. v. Tolson*, 548 S.E.2d 513 (N.C. 2001); *McKesson Water Prods. Co. v. Dir., Div. of Taxation*, 23 N.J. Tax 449 (Tax Ct. 2007), *aff'd*, 974 A.2d 443 (N.J. Super. Ct. App. Div. 2009), *certification denied*, 983 A.2d 1113 (N.J. 2009); *Laurel Pipe Line Co. v. Commonwealth*, 642 A.2d 472 (Pa. 1994).

16 Cal. Rev. & Tax. Code § 23051.5(e); Cal. Franchise Tax Bd. Notice No. 2003-9 (Oct. 24, 2003).

17 *See, e.g., Newell Window Furnishing, Inc. v. Johnson*, 311 S.W.3d 441 (Tenn. Ct. App. 2008).

18 N.J. Stat. Ann. § 54:32B-2(e)(4)(B) (emphasis added).

19 Most states impose real estate transfer taxes on direct sales of real property.

20 *See, e.g.*, N.Y.S. Dep't of Taxation & Fin., Publication 576 (June 2008).

21 *See, e.g.*, N.J. Admin. Code § 18:16A-1.5(c), Ex. 8.

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This newsletter addresses recent state and local tax developments. Because of its generality, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. If you wish to change an address, add a subscriber, or comment on this newsletter, please write to Rebecca M. Balinskas at Morrison & Foerster LLP, 250 West 55<sup>th</sup> St., New York, New York 10019, or email her at [rbalinskas@mofo.com](mailto:rbalinskas@mofo.com), or write to Matthew F. Cammarata at Morrison & Foerster LLP, 250 West 55<sup>th</sup> St., New York, New York 10019, or email him at [mcammarata@mofo.com](mailto:mcammarata@mofo.com).

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Astoria Financial Corp. v. New York City (NYC Tax App. Trib. 2016)

Clorox Products Manufacturing, Co. v. New Jersey (NJ App. Div. 2008)

Crestron Electronics, Inc. v. New Jersey (NJ Tax Ct. 2011)

Daimler Investments US Corp. v. New Jersey (NJ Tax Ct. 2019)

Dollar Tree Stores Inc. v. Pennsylvania (PA Bd. of Fin. & Rev. 2015)

Duke Energy Corp. v. New Jersey (NJ Tax Ct. 2014)

E.I. du Pont de Nemours & Co. v. Michigan (MI Ct. of App. 2012)

E.I. du Pont de Nemours & Co. v. Indiana (IN Tax Ct. 2017)

EchoStar Satellite Corp. v. New York (NY Ct. of App. 2012)

Former CFO of Fortune 500 Co. v. New York (NYS Div. of Tax App. 2017)

frog design, inc. v. New York (NYS Tax App. Trib. 2015)

Hallmark Marketing Corp. v. New York (NYS Tax App. Trib. 2007)

Kohl's Department Stores, Inc. v. Virginia (VA Sup. Ct. 2018)

Lorillard Licensing Co. v. New Jersey (NJ App. Div. 2015)

Lorillard Tobacco Co. v. New Jersey (NJ Tax Ct. 2019)

MeadWestvaco Corp. v. Illinois (U.S. 2008)

Meredith Corp. v. New York (NY App. Div. 2012)

Nerac, Inc. v. New York (NYS Div. of Tax App. 2010)

Rent-A-Center, Inc. & Subsidiaries v. Oregon (OR Tax Ct. 2015)

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Reynolds Metals Co. v. Michigan (MI Ct. of App. 2012)

Scioto Insurance Co. v. Oklahoma (OK Sup. Ct. 2012)

Thomson Reuters Inc. v. Michigan (MI Ct. of App. 2014)

United Parcel Service General Svcs. v. New Jersey (NJ Sup. Ct. 2014)

Wendy's International, Inc. v. Illinois (IL App. Ct. 2013)

Wendy's International, Inc. v. Virginia (VA Cir. Ct. 2012)

Whirlpool Properties, Inc. v. New Jersey (NJ Sup. Ct. 2011)

W.R. Grace & Co.-Conn. v. Massachusetts (MA App. Tax Bd. 2009)

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