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TO: Chair Bob Barengo and members of the Nevada Tax Commission
Deonne Contine , ED of the Dept of Taxation

FROM: Ray Bacon

SUBJECT: More Decisions, limited time, new thoughts

In a discussion recently, I learned the three of the Tax Commissioner terms expire at the end of October. Learning the work and limitations of Tax Commission and the details of being an effective Tax Commissioner are not quick and easy skills to learn. Several current and former Tax Commissioners have commented that it took them at least a couple years before understood the details enough to ask good questions. The Commission has not really had major "policy issues" to deal with since about the start of the recession and setting the rules for the Commerce Tax is going to be a major policy issue.

We suggest the Commission Chair have the discussion with the Governor soon on a couple possible options to insure the commissioners with the greatest expertise and knowledge are engaged in this regulatory process. The first option would be for the governor the meet with Chair Barengo, Commissioner Bersi and Commissioner Lambert to establish their willingness to serve another term since all three are in the retired or partially retired stage of life. If they do not want to commit to another full term, then we suggest the Governor need to extract a commitment for them to serve to the end of this regulatory process. Our understanding of the law is that commissioners serve until a replacement is named, so the governor could and we suggest should carry them over until the regulations are done and in place. For those who are willing to serve, the logical step would be for the Governor to announce they will be reappointed, so commission stability is assured through this process.

Despite the comment during this past session, we do not believe this regulatory task will be easy or quick. Much like the regulatory process in the post 2003 period, there are tons of details which need to be settled and clear definitions and procedures in place. There are business models which exist today which are not contemplated in the law. Pyramiding in the tax code is not completely avoidable, but it should be limited as much as possible. Our comments from July 2 notes just some of the few special cases we are aware of and our knowledge is very limited and many others will come out during this process and some will not surface until the first filing.

Recently, there was a business release probably on the PBS Nightly Business report that Apple is planning on the release of the next iPhone in time for Christmas sales. It may have changed, but a couple years ago OHL in Sparks was the major bonded warehouse and DC for Apple products. When the iPad II was released they processed about a billion dollars (AT RETAIL PRICING) through that facility over the first couple months. The vast majority of those were not sold to user in Nevada. If the Commerce Tax requires OHL and /or Apple to pay the Commerce Tax for all that flows through that

facility, we would expect that business to leave this state fairly soon. However, we will not have those rules in place before the product flows through a DC someplace between now and the Christmas sale season, but the tax liability will be realized prior to the rules being set. We suggest that the Tax department ascertain whether OHL is still the Apple DC or not very soon. If it is, then at least some of the commissioners and tax officials should visit the facility BEFORE writing the rules for logistic operations Tax liability under the Commerce Tax. We believe there are many other operations that have operation much like this at both ends of our state. Most will not have near this dollar impact, so a policy which clearly handles this in a logical way probably works for most logistics companies. The OHL operation was a bonded inventory for Apple, but they also did the same type of operation for other companies. I suspect they need to be separate accounts depending on the legal relationship, but perhaps all of the Tax Liability flows to OHL. Once the operation is understood then the regulation can be written. Additionally, we suspect cost and pricing information for this type of operation will be exceeding sensitive. We suggest that security of the data and what is held at the Tax Department compared to what is retained at the company will be a very heated issue. We anticipate that auditors will not be allowed access without signing very strong non-disclosure agreements and probably confirmation that the state has adequate data security measure in place. (REGULATIONS WILL BE NEEDED)

In our Prior comments we mentioned the GE and Walmart situations where they have very different types of businesses as well as ways where the product arrives in Nevada. We suggest the regulations need to place the Tax liability with the product producer for all Nevada direct sales items. A company sales operation of broker sold products to a Nevada customers and it is delivered directly to the customer.

For products which arrive in the state through a non-producing company owned distribution, we suggest the regulations need to place the tax liability with the distributor who brings the product into this state based on their Nevada sales of that product. If a DC brings in products which move back out of this state to retailers or directly to customers those would NOT be included as Nevada sales. (We think this is what the laws intends, but could be more clear.)

For products which arrive in the state through a non-producing company where the distributor is owned and operated by the retailer, we suggest the tax liability should ONLY be at the retail level for those sales in Nevada. Product moved by the DC to out of state stores would not be subjected to the tax.

For product which move through a retail distribution system, but are never owned by the retailer, we suggest the producer has the tax liability for the wholesale cost of the product and the retailer would have the tax liability for ONLY the margin above the cost. (This will be very sensitive information.)

For items sold on a consignment basis, the retail would be responsible only for the margin above what returned to the consignee. If a consignment retailer or broker sells an item for \$1000 but \$800 goes back to the property owner, then retailer has the tax liability only for the \$200. (We think this is what the laws intended, but with the limited presentation and questions this needs to be clear.)

As a general rule, the pyramiding of the tax should be limited to no more than TWICE on any material item and limited as much as possible to TWICE on any labor component in any gross revenue. There are areas where this will be tough to accomplish. As an example, a construction building materials produced in this state will be taxed when it goes to a distributor in Nevada (including the manufacturer's labor) then again at the distribution level and then a third time as part of the installation and final cost of the construction project. Because we as a state made a decision NOT to apply Sales and Use Tax (SUTA) to the final cost of both residential and commercial/industrial construction years ago, we do impose SUTA

on building materials that go to the contractors, so the Commerce Tax will compound on those at every level, without a clear regulation which limits the Commerce Tax pyramiding. We suggest the Commerce Tax should NOT include the any tax of the materials used in the construction. There is no good policy reason to make construction cost higher for either residential or commercial construction and in fact we contend that there are many reasons to lower the cost of housing. We believe that a strong case can be made that the outrageous increase in housing cost in southern Nevada prodded the questionable financing plans that ultimately lead to the collapse and the recession. This would require a change in the law that would need to be very specific in the regulations if you chose that option. What the current plan does in pyramiding the materials and labor content used in the construction industry is in our view destructive in Nevada. (Some action is needed. The construction tax rate is comparatively low, but the pyramiding is very high.)

The Clorox situation where their products manufactured in this state will be subject to the Tax when it moves to a DC in this state whether it is ultimately sold in this state or NOT, then again in many cases when the distributor sells the product and finally a third time when it sold a retail. We strong believe this violates the intent of the law, but we can find no reasonable way to reduce the triple application of this tax or reduce the first transaction to only product sold at retail in Nevada. We still believe this is wrong, but at this point we don't see a reasonable solution.

Likewise, where Walmart or any retailer/distributor provides transportation from the producer back to their DC and/or transportation to other DC out of the state, we feel strongly the product for out of state sales should not be subjected to the Nevada Commerce Tax. However, we see no easy solution to the Tax Liability compounding and multiple levels in the Supply Chain. We still believe this needs a solution, but at this point in time we cannot offer a simple solution.

Since foods are a dated product, all food products which are disposed of for whatever reason should reduce the tax at their face value since they are effectively NOT a Nevada sale. If the item is discounted and still sold through the retail outlet its sales is part of the gross revenue. If the item is donated to the food bank or other Nonprofit then it is NOT part of their Gross Revenue. This seems like a logical approach which should be universal for all operations. (REGULATIONS NEEDED)

In a related situation, we feel the law must have some provision for a deduction for inventory or service which is lost and not collected due to Acts of God and Failures of Government. The IRS code allows deduction for things such a flood, hurricane or other problems like these Acts of God or perhaps a bigger example is the losses suffered by the businesses in Sparks during the New Years' flood nearly twenty years ago. I cannot fathom that the state can find any logic to charge the Commerce Tax on companies which have suffered "you bet your company losses" during events such as that flood. The losses were partially "Acts of God" and partially multiple levels of failure government systems, such as the flood dikes, emergency systems, fires, the power grid and basic infrastructure such as roads and bridges. The law does not include any such provision and as we have demonstrated again this week, such events will continue to happen. Slapping a tax on a business which has just been kicked in the teeth is a really bad idea. This is not in the law, but to not provide some provision for tax relief for such event is perhaps more insulting that taxing a company which has no profits. (We suggest a regulation allowing a reduction for the actually expenses incurred over and above any loss allowed by the IRS,)

We believe the revenue from a sale to a leasing company and the taxing the leasing company revenue on the same capital equipment must have a solution. This is a pyramiding issue which as mentioned above needs some type of solution. We don't have a specific solution, but several options can apply.

The Clearwater paper has a clear solution in our view. If the product is sold out of this state, then it is NOT a Nevada sale regardless of how the material is transported to the customer. (REGULATORY CLARITY ON THIS POINT IS NEEDED ON THIS ISSUE)

The Tesla operation where Panasonic will pay the tax and Tesla generally will not pay the tax. (We don't believe a regulation is needed in this case, but the Tax Commission needs to understand how this works, so the commissioners are not surprised and the public is aware.)

The Amazon or internet sales and the "regardless of the FOB point" phrase is fairly simple in our view. The tax liability goes back to the shipper who shipped the product into Nevada. (We think a regulation is need to make that point absolutely clear)

The final point we had in the earlier note was on the international transaction and conflicts with international treaties. We believe the state will need some help from someone with real knowledge of international treaty law provisions to define what we can and cannot do. I cannot fathom that will ever reach the point to sending an auditor to China to conducts audits there. We have no idea what the legal guidance will be, but we need to get this point right before the tax rate increases as state during the hearing with a plan to totally phase out the MBT. (REGULATIONS AND VERY CLEAR GUIDANCE IS REQUIRED IN THIS AREA.) .

Agricultural products are often big, heavy and expensive to move. It is possible to see some growers strongly tending to sell our Ag product out of state rather than deal with our Commerce Tax. (still a concern)

We still believe the Tax Dept. must provide "Compliance Letters" to companies. We need a date when that will start and the procedure for making the request. They must have the force of law on the tax department should the rules later change. You we not capable of getting the rules in place before the tax liability started so your commitments to the taxpayers must be honored at least for this first year. (We need a date and a commitment.)

Within the last few days we became aware of a situation where NCCI (the workers compensation rating national group that Nevada and most states use) has changed the insurance classification for some accounts in this state. In one case the classification had been the same for 37 years. We don't know if the NCCI change will impact their NAICS code or not. On the surface, it appears that is should not, but this change further supports our contention that the NAICS codes in this state are not truly under the control of the employers and many may be in error. Short after joining NMA I worked with DETR and found that most of the furniture stores in this state were listed under a manufacturing SIC instead of retailing. We corrected that, but in most cases the employer was not involve in setting the codes and it is likely we still have problems in that area.

We will have some people or corporation who own companies in very different businesses with very different NAICS codes. We will need a process which makes common sense to deal with those when they show up and they will. We have no idea how many of those we will find, but suggest defining how those are going to work is easier than having all of them become item to resolve at the Commission.

A dated FAQ section (which is searchable) will comply with the principles of the Nevada Taxpayers Bill of Rights because someone will rely on what is on the website. What was on the website must be legally binding on the state during the period before the change was made. Collections and litigation on areas where the FAQ section was wrong or has changed need be very limited. Nevada has created a tax that does not exist anyplace else that we can find. We will have flaws and challenges and changes required and in most cases the taxpayer should not be penalized for good intentioned compliance which turns or

later to be wrong or changes. We believe the tax commission should review and formally approve all of the changes.

We strongly suggest a simple form for all companies where the gross revenue is under \$4 million be allowed to return a simple electronic or post card filing which provide just the basic data and their assertion that the gross sales is under \$4 million in total. At least for the first couple years, it make no sense to hire people to move paper you have no reason to look at until system are developed to handle the data quickly and electronically without any handling by people. We agree with Mr. Wachner for RAN at the workshop on July 7th. Companies using the simple report will still be subject to audit. If the filing is electronic as it should be, tax should be able to quickly sort those who claim gross revenue under \$4 million to those who report MBT of over \$XXX,XXX per quarter to tag those who need a closer look.

We are not sure it can be done the way the law is written, but the logical way for compliance with this law would be to make the file due to the state 30 days after they have completed their IRS filing. The total revenue is going to be the same, much of the data is going to be the same or come from the same sources so aligning the reporting period to the federal compliance data and the actual filing date levels the department work load, and makes the compliance easier and probably faster and cheaper for the regulated community.

At the July7 workshop you got an earful on the NAICS codes issues. We think that will require a separate series of workshops, but what we have now probably doesn't work.