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TO: Chair Bob Barengo and members of the Nevada Tax Commission

FROM: Ray Bacon

SUBJECT: Big Decisions, limited time, confusion and the Tax issue

This is going to be a long note. The tax bill passed is 103 pages, it is complex, and it has parts very unclear as to what they mean and how they will be implemented. The tax become effect then even though the rules, forms and compliance questions will not have answers for months and the first year payment will be due in mid-August or 2016. The rules and understanding of what is in the tax is NOT known by those that wrote it and pressed its passage and much like 2003. You on the Tax Commission have the huge task of figuring out what the rules really need to be a way where the average taxpayer can figure it out and pay without a huge risk audits. You have a huge task and while we may disagree in the end, NMA recognized the magnitude of the task you face is huge and the guidance from the law is suspect in some areas. We believe Legislative legal will decide you must write regulation which may change the law or clarify to reach a functional system. We wish you "good luck and God speed" as was given to John Glenn on the first orbital Space Mission. We suspect you may need it.

As the 2015 session started, we had great hopes that some real tax policy corrections, changes and improvements as well as the expected increases would be part of the end result. We know we have "goofy" tax policies throughout our tax code and in the end most were not fixed and we fear we have created another tax policy which has basic policy flaws which will haunt us for years "work arounds", changes and exceptions. Our property tax is the only one with a depreciation schedule. Our sales and use tax has the 2% issue from the referendum 60 years ago. Our LET is much improved, but it is still a tax with two masters. Our personal property tax has a depreciation schedule different than the federal schedule. Our economy has shifted to services which we have known and discussed for about two decades and done little to develop and tax code which matches our economy. The huge portion of federal land ownership so limits the effectiveness of the property tax system which is a mainstay in most states, but we do little press for real needed change in that area. Even our gaming tax which is leverage way too much on the baccarat factor is nuts. To leverage so much of the state's expectation on something with so few players and so little Nevada control makes little sense

Several of the questions and scenarios we present in this were asked during various legislative hearings and not answered. Over the years, I have witnesses several occasions where a legislative body dissolved into a "committee of the whole" for a particular issue. Never before have I witnessed a process where the members of the Committee of the Whole were not allowed to ask questions of the witnesses providing testimony to the committee. In my opinion, the body showed a flagrant disregard for any effort to provide you with a record to use to reach the decisions you need to make to reflect legislative intent in the regulations you have to write and make a system which is fair and honest to the taxpayers on which the rules will be imposed. I firmly believe their action on what was essentially a new tax plan within days of the session end makes your task extremely tough. Since this tax leans heavily on the good producing

sector which is NOT located in this state, we have a great respect for the magnitude of your task and will attempt to be as helpful as possible in reaching a systems which works with a minimal level of confrontation and litigation. A good taxation process should never result in litigation for an average taxpayer.

In these examples the company names will be used whether they are NMA member or not because they tend to show the details and complexity involved in compliance. We will suggest in some cases what is in the laws actually makes reasonable compliance much tougher than should be required. I have not asked for permission to use these companies in these examples. The example is not exclusive to this or any company but provides a good illustration of what we believe the rules need to understand and adjust where possible.

General Electric – GE owns two production facilities in Nevada. They have a locomotive rebuilding operation in southern Nevada and the former Bently Nevada Corp, facilities in Minden. In both cases few if any of the products from the plants are sold to customers in Nevada. So in this case the Commerce Tax will be zero or very low for the products made in Nevada and sold here. Between the two operations GE has over 1000 employees in the state. Most of those have families which use our Nevada resources whether that is our schools, water, roads and services. The companies and their employees pay all the taxes that others do in this state and probably a little more than their average since they tend to be above average jobs in this state. GE is a very large and complex company with divisions which are large than the Nevada state government. They make complex and expensive medical equipment, power generation equipment, motors, renewable energy products, jet engines, controls, appliances and thousands of consumer good down to silicon caulking, switches and light bulbs. Some of those products are imported from their plants located around the world and many are made domestically. Most of those large products are sold directly by GE, so while not easy accountants in the divisions can consolidate the GE direct sales of products in Nevada for purposes of complying with our Commerce Tax. GE also makes many products which become parts of thousands of other products which are sold as end product. The easiest to understand is perhaps their jet engines on airplanes. If Allegiant buys a plane the engines are part of the plane. If they buy a replacement engine it is a separate sale and would be subject to the Commerce Tax as a GE sale in the second case but not as part of the plane. The sale of the plane would be counted as a Nevada sale from who built the airplane.

This is actually pretty simple, but I believe you will need a very clear and rather complex definition of what is a Nevada sale and what is not. If a part is delivered as part of a complete unit when sold into Nevada which is or is not subject to the tax then the component part is NOT subject to the Commerce Tax. That solves a small portion of the pyramiding issues created in this tax, but it gets worse.

GE also makes mundane items such a light bulbs and florescent tubes. Those are delivered to through multiple distribution channels and in most cases GE has little if any ability to know how many arrived in Nevada and from which distribution channel. Those products might arrive in the state through Walmart, Target, Home Depot, Lowes, Ace Hardware, grocery stores and hundreds of other sources. All of those entities will be subject to the Commerce Tax, but when the questioned was asked whether GE would be subject to the Commerce Tax on something like a light bulb there was no answer. It might seem like a simple question, but it is not. If the answer is the Commerce Tax applies only at the first transaction into this state, then the "getting the big guys myth" doesn't work. If it does apply to all then the tax pyramids from the producer, through one or more levels of distribution and includes the retailer. Should the product be installed, then the installed cost might add to the delivered cost of the 50 cent light bulb. This definition needs to be very clear and the education of the taxpayers located where ever needs to be really great or compliance will be a nightmare and auditing nearly impossible. If you cannot conduct an audit in a defined and consistent way in all cases then you have an absolute mess. Right now, we suggest that

mission is total in your hands to correct and it will be extremely difficult. Should you lean toward pyramiding of the Commerce Tax through all levels to get back to the producer in every case for all products, and then we suggest the compliance cost will damage business in this state and create a bureaucracy which will make the IRS look small. The diminishing returns to Tax back to the source for items sold through the distribution channel may be far greater than the revenue gained. In multiple attempts to have this discussion, eyes tended to glaze over, so it is now left to you to resolve.

Our recommendation would be a rule that the tax can only apply to the transaction that moved the product into this state whether that comes directly from the manufacturer as is likely for most capital goods or from a distributor and to one retail transaction within the state. That will limit the pyramiding to no more than two times per product sold in Nevada. Where the distribution is handled by the retailer such as many products sold by Home Depot, Lowes, Target, Ace Hardware stores or Walmart the product will only be taxed once at the retail level. (REGULATIONS NEEDED)

Clorox makes cleaning products, Kingsford Charcoal and Hidden Valley Salad Dressings. They have a plant at Stead which makes the Salad Dressings. In most cases the product is sold through some of the roughly 3000 grocery and food distributors in this country. In the state of Nevada, we have only two company owned grocery distribution centers. The first is the Scolari's in Sparks and the second is the Walmart DC at TRIC. How is the system going to avoid HV product shipped to the Walmart DC from being taxed whereas the most other grocery DC's are in CA. The sales tax system works because it is a collection at the consumer level whereas this system muddies the waters enough that no one knows. Throughout the manufacturing sector the "resellers permit" separates the product purchased for sale to the end user from what will be used in the product of the product being made by a manufacturer and taxed as part of the sale of the end product. The proposed Commerce Tax in some cases seems like a second SUT, but in other cases it is not. The business community must KNOW the rules before the process starts. If the Tax Commission doesn't take the steps to define the rules then the number of court cases will skyrocket. The logical path would be for Hidden Valley to pay the Commerce tax only on for the product shipped to a Nevada location from the factory for sales in this state. In most cases on products sold through the distribution system, the manufacturer will not know, so the tax may be better collected at the Distributor and/or Retail spot. (REGULATION NEEDED) The Commerce Tax for the other Clorox products would be paid by the distributor would bring the product into the state. This means the salad dressing going to the Walmart TRIC DC destined to go to markets in California would be Subject to the Nevada Commerce Tax first. Most other Hidden Valley products would pay the Commerce Tax based on when the distributor brings the product into the state and when the retail sale is made. If the distributor who brings the product into the state is the Retailer as well the DC is essentially a "wide spot in the Supply chain" and would NOT be a separate taxable event.

One of the things Walmart does better than nearly all of its competitors is its logistic operations. Its truck fleet (4th largest in the US) routinely carries a load most of its operational time. They pick up goods to go to their DC from thousands of suppliers every day. It saves shipping cost, reduces traffic, reduces cost, reduces pollution and in the end helps keep their prices low for consumers. They move goods between their DC's. A small operation such as Killer Salsa in Gardnerville moves their product to their largest customer via their customer's trucks. The lack of freight cost allows them to be a viable supplier to the world's largest retailer whereas otherwise they would likely not have them as a customer at all. Their approach should be rewarded. They should only pay the Commerce Tax on that sold in their retail or wholesales operations and NOT on the goods which flow through the DC's to their retail stores in other states. We believe that is consistent with the intent of the law that we are attempting to capture the Commerce Tax for good sold in Nevada. (REGULATIONS NEEDED)

There is one additional thing which Walmart does which will upset the ability to audit their account. For a growing number of their commodity type items they use an innovative approach with some vendors. Proctor and Gamble (P&G) was one of if not the first to engage with Walmart in this process. Walmart receives replacement stock from P&G daily based on what was processed through the cash registers consolidated by store every day. The consolidate store report is in the inventory document, sales document, authorization to pay the vendor and actually process the money transfer. The P&G product may sit in the Walmart DC's for a few days, but effectively Walmart never owns the inventory. P&G owns the product until it becomes a customer sale. This is sort of like a consignment sale where the consignee never owns the product, but collects the money as pass through revenue to remit to the property owner. The pass through revenue does not appear to consider. The pass through revenue section doesn't seem to contemplate this type of transaction. The paperwork reduction because both companies are dealing with the same data and all the intermediate paperwork is gone is a significant cost savings.
(REGULATION MIGHT BE NEEDED)

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)

The regulations suggested above are needed partially to reduce the impacts of pyramiding the tax structure. In his presentations, Jeremy mentioned there would be some pyramiding, but carefully drafted rules can dramatically reduce the incidents of this. For small dollar items the pyramiding impact per item is small, but the cumulative impact is huge.

Here is an example we strongly suggest should be avoided because it will drive business out of Nevada. A manufacturer located outside of this state, sells \$millions in some type of heavy equipment to their dealer in this state who sell it to a leasing company in this state who leases it the equipment to the end user in this state with lease payment in the millions of dollars each year. As the Commerce Tax was explained (we think because the answer changed at times), the state of Nevada expects to collect from the Manufacturer, from the dealer and from the leasing company based on the lease payments. Tripling the Tax on any expensive item or group of item will prod people and companies in to extreme efforts to avoid the Tax. That can only hurt Nevada and Nevada Companies. In the manufacturing sector with few exceptions the discrete parts and component used to make the products are not subject to sales tax and sales tax is applied only at the finished good sale. This is not new and has been that way in most place for decades and is a factor in keeping "Made in America" goods competitive in global markets. A Nevada manufacturing company buys parts produced elsewhere to be a part of their product(s). Throughout the country and actually worldwide the general rule is manufactured goods are only taxed at the sale to the end user. Changing that creates the biggest risk of pyramiding in the tax structure. As a non-Nevada example, an auto or an airplane manufacturer has thousands of suppliers and suppliers to their suppliers in the complete supply chain. In the electronics sector, 7-12 levels typically exist in their product structures. The auto industry has a few more and the airplane industry has probably 20-30 levels in their full drop down product structures. Taxing each level will be adding cost at every level whether the supplier was in the state of Nevada or shipping their portion in from anywhere else in the world. It would add taxes on taxes which is the main reason it is not done in normal trade. If we changed the current practice, then it will tend to make Nevada less viable to produce products in most markets. (We suggest the law is unclear on this point and Regulation or Guidance is needed to make the point very clear – either way.)

Clearwater Paper makes many store brand paper products in the items such as toilet paper, paper napkins, facial tissues and paper towels. Part of their strategic advantage is that Las Vegas consumes so much more than it produces for outbound products. Most of the grocery items for the Las Vegas Valley come from DC's in Southern California. Keeping Las Vegas in food takes hundreds of trucks daily, so much like the Walmart example the product ships back to the DC's in the grocery owned or contracted trucking. The sale is between Clearwater and the Grocery companies, paper distributor and others, but it leaves their plant usually in customer's company trucks. As you know the quality of the I-15 roadway in California is far from great so often the Refrigerated Trailers are loaded with Clearwater paper products to pad them on their way back to California. Forty to 50 trucks per day is common to be packed and padded with paper for their trips back to the CA distribution centers for various grocery operations. We believe the effective point of sale is the DC's in southern California rather than the dock of the Clearwater factory in NLV. Much of the same process takes place for Oceanspray, the Unilever Ice Cream plant and dozens of others operation in southern Nevada. The finished product needs to get to the DC's usually in CA, but also in AZ and UT but the end product is NOT destined for sale in Nevada. (REGULATORY CLARITY ON THIS POINT IS NEEDED ON THIS ISSUE)

On at least a couple of occasions various people connected with the administration said off the record several times that the Commerce Tax would not be subjected to the tax abatement process and it was not being considered as a target for future tax abatements. At other times the statement was made that the Commerce Tax would not impact the Tesla project under construction at TRIC. We fully agree that the plan at this point in time is the finished battery packs for the Tesla vehicle will be shipped to the Fremont, CA vehicle assembly plant for installation in the vehicles. Tesla could handle this as an internal company transfer if the battery assembly plant is a cost center only or even a separate profit center. Both approaches are used in the assembly process of large items such as autos, planes and some large machinery. However, the implication was that the transfer of the batteries between Panasonic and Tesla will also NOT be subjected to the Commerce Tax appears to be bogus. Clearly it will be a sale between two major companies in Nevada. If Panasonic runs the entire operation and provides the finished battery pack ready for shipment to Fremont then perhaps the tax is avoided. Otherwise the transfer of the batteries from Panasonic to Tesla should be a Commerce taxable event. (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.)

Section 22 subsection 1(d) of SB 483 talks about the "regardless of the FOB point", so my guess is that all items shipped to a Nevada address from any Amazon, Zappos or other internet sales based operations must be included in their Gross Revenue for purposed of this tax. That would appear to make this tax tough to comply with for many companies with operations and divisions scattered around the nation or the world, but customers in the state. It becomes very complex in the non-durable consumer goods. Additionally, it appears if the products come and are sold into Nevada from a distributor that Nevada wants a cut there also, as well as any retailer involved in the sale. That clearly is pyramiding and while small rate at this time it is guaranteed to increase with time. Perhaps a bigger question, is will Nevada attempt to get a SOS registration for every seller who markets through Amazon if they happen to sell a products into Nevada? Will Nevada attempt to go upstream to the actual manufacturer which supplied the product to Amazon? Will Amazon have any reason to share their supplier base with the state of Nevada? As we said above, we think that the Commerce Tax must stop at the entity which sells the product into or in Nevada and in most cases cannot go upstream to the manufacturer unless they ship the product into this state via some fairly direct method. Clearly, the law is unclear and the Tax Commission seems the entity like to provide the clarifications needed. (REGULATION NEEDED)

If the state of Nevada is going to attempt to collect the Commerce Tax all the way to the manufacturer for all good sold in this state then the process get complicated, the audit trail nearly impossible and opening a Pandora's box which might be better left closed. Many of the goods sold in this country are products from foreign countries. Some of those companies are in place when the US has some type of Free Trade Agreement. The provisions of those agreements vary significantly by country and in some cases by commodity. At this time those countries include Canada, Mexico, parts of Central and South America, part of the EU and soon large portions of Asia except China. The thought of Nevada trying to impose a Nevada Commerce Tax on the foreign Manufacturer is pure folly. First they will ignore our reporting requests, many items are made in multiple locations and we are not convinced we have any ability to block a legal item from entering this state with violating the Commerce Clause and existing trade agreements. (REGULATIONS AND VERY CLEAR GUIDANCE IS REQUIRED IN THIS AREA.) The worst scenario we can fathom is a Nevada decision which would attempt to impose the Nevada Commerce Tax on all US made products and not on those made in foreign companies. In some cases large capital goods arrive in this state directly from a foreign producer where Nevada might make a serious effort to collect this tax and we expect we will fail unless there is a US broker or dealer or agent of some type. This could happen in the case on large commercial PV solar installation if the construction company made a deal to buy the panels direct from the Chinese producer.

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.

The mechanics of Compliance with the Commerce Tax

The director has indicated she does not expect to hire auditors for the first couple of years. They will need revenue consultants, auditors or someone immediately to be part of helping companies comply with what appears to be a complex law to understand and comply with for many companies. Companies should demand the ability to request a "compliance letter" from the Dept. confirming their approach to paying the tax will be OK and they will not be subject to fines and penalties later if they follow the agreed upon path. That means the Dept. needs high end understanding people immediately able to provide clear guidance by people who don't seem to have a great grasp on the cost of collections and the company cost of compliance. Taxpayers must be able to get prompt answers to rather complex questions with a high level of certainty that the answers are correct and legally binding. We suggest once you have absorbed what is in the Tax and how you plan to collect that Tax will need a "Legally Binding" FAQ section on their website. We suggest that the entries need to be dated and NOT just show the current answer. Some of the answers are going to change over time. Hopefully most will be correct and not change, but some will change by court decisions, methods which turn out to be unworkable or expensive. 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 and 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. Those companies should be off this list each

year without further effort unless the Department gains knowledge to believe that statement not to be true. If their total sales are under \$4 million then their Nevada sales will be under \$4 million. That drops thousands of companies off the list immediate in a 5 minute or less filing. That makes the compliance burden much less for them and much less for the department.

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. Right now the first filing is all in August 2016 whereas changing to align with the federal compliance data would likely move the revenue a months earlier for the largest part of the taxpayers. It just seems easier and smarter for everyone involved and in the long term the revenue total is going to be the same.

The law says that each company will be charge to the Commerce Tax based on the NAICS code for their primary operations. It does not define where that is the primary NAICS code for just their Nevada operations or their products or service sold in Nevada or on a national basis. We suggest the Tax Commission will need to define what it is. We also strongly suggest for many of the national and international firm where you want to collect this tax you might to consider establishing a NAICS code for different Division when the products and processes are very different. GE still owns GE Capital as well as it heavy industries and consumer products. We suggest the Tax Commission may need to rewrite the law in that section to get to something which actually works or at least works better.

Unfortunately, our assessment is the task for the Tax Commission is nearly as great as they faced in 2003 where the Commission had to write laws because so much was missing from the law in terms of the details necessary to make a functioning tax system. It may in fact be much larger and nearly impossible. It is our intention to stay engaged during this process to make something which works in spite of serious concerns about the wisdom of this tax plan. We note there was little dispute about the need for prudent and performance measure increased spending, however to quote Carole Vilardo, "the Devil is always in the Details" and in this case we are very concerned that no one even has a clue what the devil is going to become.