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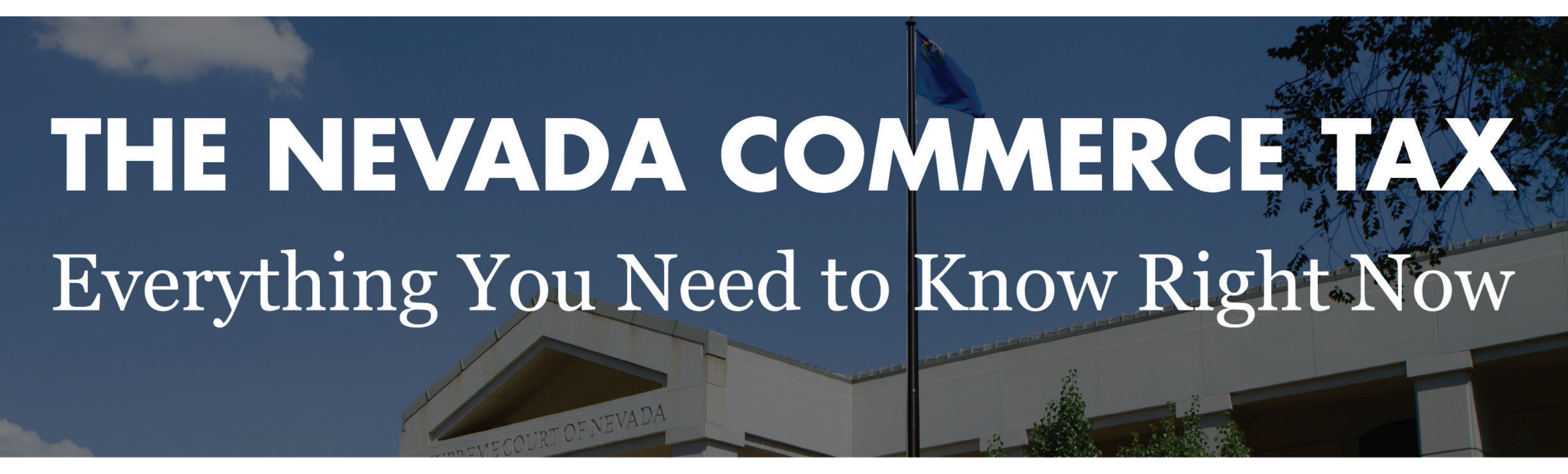

THE NEVADA COMMERCE TAX

Everything You Need to Know Right Now

INTRODUCTION

The 2015 Nevada State Legislature, which had a Republican majority in both houses for the first time in more than 60 years, passed and the Republican governor signed into law, the largest tax increase in Nevada history. The centerpiece of that tax is the Nevada Commerce Tax (the "NCT"), which is a tax not on the net income of businesses, but on the gross revenues earned in Nevada, subject to certain deductions, of most businesses operating in Nevada. The act creating the NCT is complex and will require every business subject to the tax to change the way they keep financial records, even if they eventually do not owe any amount under the NCT. Almost as importantly, the first fiscal year of that tax is July 1, 2015, through June 30, 2016, so there is not much time for businesses to implement any changes they will need to make to comply with the NCT. The sections below provide some detail about the tax and also raise some issues that will have to be addressed through regulation or otherwise.

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WHO - IS (OR IS NOT) SUBJECT TO THE COMMERCE TAX

The short answer is: virtually every business in Nevada. The NCT will affect sole proprietors, partnerships, and corporations, as well as service providers such as medical professionals, attorneys, and accountants, and persons engaged in the sale or rental of personal and real property. The businesses and organizations exempted from the NCT are certain nonprofit organizations, credit unions, trusts and a so-called "passive entity." [1] Although there is a $4 million gross revenue threshold before a tax is due, virtually all businesses in the State of Nevada will be required to file a return that indicates the amount of their gross revenues (as required to be calculated under the NCT) and such business entities are subject to audit. As further discussed below, for those subject to the NCT, in the absence of regulations to provide clarity, they probably don't know exactly what revenues should be counted. So, the first year's filing might be challenging. In short, the vast majority of businesses will be subject to the NCT, although they may not have any tax due. The takeaway is that businesses need to take a close look at the provisions of the NCT to see what revenues are to be counted in "gross revenue" and do their best to calculate "taxable gross revenues" so that when the end of the year comes, they will be able to file a return that they believe is reasonably accurate.

[1] A passive entity is defined as a business entity (oddly, other than a corporation) that derives 90% or more of its revenues from passive sources such as dividends, interest, other financial transactions, capital gains from sales of real property or securities, or mining royalties.

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WHAT IS CONSIDERED TAXABLE GROSS REVENUE

The NCT is levied on a business entity's taxable gross revenue ("sitused" to Nevada, as discussed below). Gross revenues are the amounts realized on transactions that contribute to gross income, without deduction for the cost of goods sold or other expenses incurred. They include gross receipts from the sale of goods, performance of services, and rentals or leases. Certain receipts are excluded from the gross revenue calculation, including receipts from the sale or lease of intellectual property, customer cash discounts and gifts, certain capital contributions and distributions, and charitable contributions.

From this wide net of gross revenue, a taxpayer is entitled to certain deductions. These include deductions for certain taxes and fees, "pass-through revenue" (e.g., sales commissions paid to an independent contractor or revenue paid from one affiliated entity to another), bad debts, refunds and amounts realized from the sale of accounts receivable (if the receipts from the underlying sale are included in the tax base).

Finally, a taxpayer is entitled to deduct from its gross revenue receipts that are "prohibited from taxation by Nevada under the Constitutions or laws of the United States or Nevada." Presumably this would include revenues preempted from state taxation by federal law, such as any receipts from any FAA licensed aircraft (or hot air balloons). More generally, this provision could be seen as a prophylactic measure to insulate the act from possible Commerce Clause challenges. Under the U.S. Supreme Court's Complete Auto test, a state tax such as the NCT can be invalidated if it purports to tax activities with an insufficient connection with the taxing state, or captures more than its fair share of a taxpayer's revenue (the NCT also attempts to avoid this through the "situsing" provisions discussed below).

At first glance, then, it seems as if "taxable gross revenue" for the NCT may be simpler to calculate than net taxable income for federal income tax purposes. And, eventually, it may be. For now, though, we have a very broad definition of gross revenue and a delineated set of deductions that are different than the revenue and deductions that a taxpayer would accrue and report for federal income tax purposes.

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WHERE IS TAXABLE GROSS REVENUE "SITUSED"?

The NCT applies to those taxable gross receipts which are "sitused" to Nevada, "situs" being Latin for the "place where a particular event occurs." The revenues of a business that are "sitused" to Nevada are subject to the NCT; the revenues of a business that are "sitused" outside of Nevada are not subject to the NCT. The rules for revenues from sales or lease transactions are relatively clear. Gross revenues from sales or leases of real property located in Nevada are sitused to Nevada. Revenues from sales of tangible property are sitused based on destination.

The catchall for revenues from the sale of services (other than "transportation service," which have a Nevada situs if both the origin and destination are in Nevada) is less clear: such "gross revenue" is sitused to Nevada "in the proportion that the purchaser's benefit in this state with respect to what was purchased bears to the purchaser's benefit everywhere with respect to what was purchased." In making this determination, the "physical location where the purchaser ultimately uses or receives the benefit of what was purchased shall be paramount in determining the proportion of the benefit in this state to the benefit everywhere."

This "services situsing" provision, mirroring a similar provision in Ohio's gross receipts, is based on the location of the purchaser of the services, as opposed to the location of the revenue generating business activity. Some commentators contend that the Ohio rule is constitutionally suspect because it does not allow apportioning revenues to avoid the taxation of the same revenue by two different states. To help "clarify," Ohio has adopted situsing protocols for more than 50 enumerated service types including accounting, data processing, financial planning, legal, management consulting, market research, payroll, tax preparation, telecommunications, and testing laboratories. Click here to see the codes.

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WHEN DOES THE NCT GO INTO EFFECT?

The NCT has already gone into effect - at least for purposes of coming up with the administrative rules and forms. The Nevada Department of Taxation will unveil some of these at its first public workshop on July 7. However, even prior to that date, starting July 1, 2015, taxpayers must begin keeping records that will allow them to file an accurate return under the NCT for the next 12 months, with the first yearly installment due August 15, 2016.

This is a very aggressive implementation schedule. In comparison, it took Ohio seven years to fully implement its commercial activities tax, and after adopting its margins tax, Texas took three years to begin collections.

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HOW IS THE NCT CALCULATED AND ADMINISTERED?

To determine the applicable tax rate, a taxpayer must select the appropriate business category for each entity doing business in Nevada. This is significant because once the business entity designates a business category on the initial report, the designation may not be changed unless the business applies and the Department of Taxation agrees to the change. An entity engaged in more than one business category is "deemed to be primarily engaged in the business category in which the highest percentage of its Nevada gross revenue is generated." Accordingly, a Nevada business with gross revenue in more than one category will need to consider the highest percentage of gross revenue attributable to Nevada, rather than the highest percentage of all gross revenue, in order to determine the correct business category for commerce tax purposes. Finally, all businesses are entitled to subtract the first $4 million from their annual gross revenue, with the applicable tax rate being applied to the balance.

Businesses will report and pay annually to the Nevada Department of Taxation on a fiscal tax year running from July 1 to June 30. The first payment is due August 15, 2016 and covers the period of July 1, 2015 - June 30, 2016 with payments due each August 15 thereafter.

In accounting for the Commerce Tax, a business must use the same accounting method as it does for federal tax purposes. Any overpayment claims for potential overpayment must be filed within three years.

It should be well noted by all Nevada businesses that all taxpayers are subject to audit, even if their revenues are below the $4 million threshold. Additionally, taxpayers must maintain records for four years or longer if in litigation.

A business with more than $200,000 in Nevada based payroll may apply 50% of the NCT paid in a tax year as a credit against any modified business tax ("MBT") tax liability. This credit is only available for the four quarters following the tax year in which the Commerce Tax was paid. Businesses may not carry forward unused credits and no refund will be issued if the credit exceeds the businesses MBT liability.

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WHY DID NEVADA ADOPT THE NCT?

To create what he termed "The New Nevada," Governor Brian Sandoval proposed a tax increase that would be used to fund Nevada's struggling education system and restore social service programs that were cut during the great recession.

The concept was supported by the majority of businesses, but there were concerns about the mechanism that would be used to exact the tax. To fund this ambitious budget the Governor proposed Senate Bill 252, a tax on Nevada allocated gross revenue tied to 30 industry specific rates at nearly 70 different levels of revenue.

While a large number of businesses, including the gaming industry, supported SB 252, the gross revenue tax was controversial. This controversy lead to a coalition of Assembly Republicans and some state businesses proposing their own tax plan that relied on a flat increase to the modified business tax. The Governor, wanting to establish a new state funding mechanism, took the suggestions laid out in the other tax plans and incorporated them into a consolidated plan. This proposal was supported by many businesses and business associations including the Nevada Resort Association and eventually the Las Vegas Metro Chamber of Commerce. In historic fashion, the Nevada Revenue Plan was passed with bipartisan support on June 1, 2015.

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If you would like to learn more about the **Nevada Commerce Tax**, please contact one our experienced attorneys.

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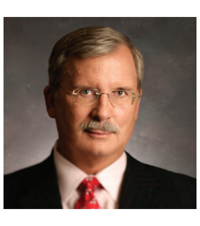

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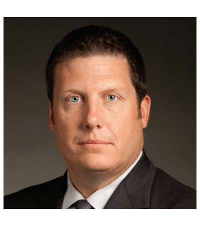

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