

TAX TOPICS

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Editors' note: The teachers' union has geared up to win support for their margin tax initiative. At the request of many members, this edition of Tax Topics has been updated to reflect the August 2012 amended filing of the initiative with the Secretary of State's Office, and as it was subsequently delivered to the 2013 legislative session. Since no legislative action was taken during the 2013 session, the initiative will appear on the November 2014 general election ballot. The changes between the version filed in June of 2012 and the refiled version is highlighted in green. This update is as of September 3, 2013.

The Unions' Tax Initiative: More Problems

We first reported on the unions' tax initiative in a special electronic edition of Tax Topics, which can be found on our website. The initiative which was filed the morning of June 6 brought to fruition the threat of such a filing made by the AFL-CIO and State teachers union during the 2011 Legislative session. The initiative imposes a Nevada margin tax that according to the unions would be based on AB 582 of the 2011 legislative session and the Texas margin tax. Points to remember: AB 582 was introduced at 9:50 p.m. the last day of session and never vetted. The initiative, which adds a new chapter of law to Nevada statutes contains 26 pages of detail plus a 200-word description. The Texas margin tax has had enough problems that more than 45 bills were introduced during the last legislative session in Texas to correct problems that surfaced. And the problems are still surfacing!

Some General Observations

Based on the section by section summary and comments, which begins on the next page, it is naive to think that the tax won't have serious unintended consequences, if it should become law.

The title of the initiative is "The Education Initiative"; however, the revenue from the tax is not appropriated for education. A better and more accurate title would be "The Margin Tax Initiative."

Proponents claim the \$1 million exemption protects small businesses. Not true. The calculation of total revenue pursuant to the provisions of the initiative will put the income of many small businesses over \$1 million. Those small businesses will include many franchise operators with a single location, most independently owned gas stations, many medical clinics, ranches and farms and a host of other businesses. In reality it is only the tiny business that will not be captured.

The rate of the tax in AB 582 and SB 491, 1st reprint was 0.8%, other than their want for more revenue, why a rate of 2%? The rates of the Texas margin tax (0.5% for retail and wholesale trade and 1% for all other businesses) were established to provide an offset for a reduction in property taxes.

In the amended version of SB 491, 1st reprint, hospitals received an exemption to mitigate the impact on health

continued next column

care costs. This provision disappeared in AB 582. Do proponents think the cost of health care has come down? There is an acknowledgment that the department of taxation will need additional funds to administer the tax, but, will the funds be sufficient? That is an unknown at this time.

This tax is not based on the ability to pay. As a result many small businesses will find their profits wiped out. For many businesses hurt by this economy that have been struggling to keep their doors open, this tax may prove to be the proverbial straw that broke the camel's back.

The Texas margin tax has created substantial increases in the costs of compliance for business. Nevada businesses will face these same increases in addition to paying the tax at a much higher rate. This tax is a full-employment bill for accountants and tax attorneys.

And don't forget, if the initiative goes to the voters and is approved, it will be three years before any changes can be made. The question will then become to what extent can the Tax Commission do regulations? Remember that in 2003, the Commission wrote law in order for the tax provisions of SB 8 to work. Would regulations they propose be viewed as trying to change law?

We will keep you updated as other problems and questions that are brought to our attention by you in future *Tax Topics* and *NTA e-briefs*.

Section by Section of The Tax Initiative

SECTION NUMBERS	<u>SUMMARY</u> <u>COMMENTS</u>
1&2	Enacting clauses of the initiative. States that the initiative is to enact a margins tax by adding a new section to statute.
3-17	DEFINITIONS
4	<p>“Affiliated Group” - 2 or more business entities controlled by one or more common owners (ownership not required in all cases.</p> <hr style="width: 20%; margin-left: auto; margin-right: auto;"/> <p style="text-align: center;"><i>The following are examples of affiliated groups under this definition:</i></p> <ul style="list-style-type: none"> • <i>Two or more partnerships with a common general partner</i> • <i>A sole proprietor (individually) and any partnership in which he/she is a general partner.</i> • <i>Two or more limited liability companies owned by a common individual managing member.</i>
5	“Business” – Any activity intended to directly or indirectly benefit any person..
6	<p>“Business Entity”– All but a credit union, governmental entity, an entity which is prohibited by Federal or State law from being taxed, or a natural person who does not file Schedule C, E or F with form 1040.</p> <hr style="width: 20%; margin-left: auto; margin-right: auto;"/> <p style="text-align: center;"><i>A natural person individually constitutes a business entity if such a person is a sole proprietor. All trusts, partnerships, flow-through limited liability companies and S-Corps are included in the definition of a business entity. As such, certain individual’s income is potentially subject to the tax despite a Nevada constitutional prohibition on individual income taxation (paragraph 9, section 1 of § 10).</i></p>
7	“Combined Group” – An affiliated group required to file a group form per section 28.
8	“Commission” – The Tax Commission.
9	“Controlled by” – Possessing the direct or indirect power to direct or cause the direction of management and policies of a business entity by any means.
10	“Engaging in a business” – Commencing, conducting, continuing or liquidating a business.
11	“Government Entity”– Federal, state and local.
12	“Lending Institution” – An entity that makes loans; and is regulated or licensed by federal or state regulatory bodies; is a broker or dealer per 15 U.S.C. §78c; or provides financing to unrelated parties solely for agricultural production.
13	<p>“Pass-through revenue” – Revenue received by a business solely on behalf of another in a disclosed agency agreement; taxes collected from a third party; or reimbursements for advances made on behalf of a customer.</p> <hr style="width: 20%; margin-left: auto; margin-right: auto;"/> <p style="text-align: center;"><i>As defined in the initiative this definition is much broader than the Texas definition and will be extremely difficult to estimate.</i></p>
14	“Taxable Year” – The year used for purposes of federal income tax.
15	“Total Income” – The total amount received by a business from all sources without subtracting any costs or expenses.
16	“Total Revenue” – The total revenue as determined under section 25 24.
17	“Unitary Business – Business characterized by unity of ownership, functional integration, etc.

3-18	DEFINITIONS CONTINUED
18	<p>“Passive Entity” – Various statutory partnership classifications and trusts (excluding business trusts) that during a period have at least 90 percent of their federal gross income consisting of dividends or interest and royalties, bonuses or various minerals properties or interests. Rent, and certain income from mineral properties operated by affiliates is excluded from gross income.</p>
19 - 22	<p>PROVIDES FOR AUTHORITY AND ADMINISTRATION OF THE DEPARTMENT OF TAXATION</p>
19	<p>Provides for the administration and enforcement by the department. Authorizes the adoption of regulations as necessary. Allows the department to retain the necessary revenue from taxes, penalties and interest collected to administer the tax and provides that the remaining taxes, interest and penalties are to be deposited to the Distributive School Account in the State General Fund.</p> <hr/> <p><i>Identifying the DSA in this section is the closest this initiative gets to referencing education, and there is no requirement that education funding be increased or even that the funds be used in the classroom.</i></p> <p><i>By providing that the department is allowed to retain whatever revenue it decides is necessary to administer the tax without legislative approval, has the budget process been side-stepped?</i></p>
20	<p>Requires each person responsible for maintaining the records of a business entity to keep records for at least 4 years and makes records available for inspection. Provides the department may specify the records to be kept. A person who violates the record-keeping provisions is guilty of a misdemeanor.</p>
21	<p>Authorizes the department, or any person authorized in writing by the department, to examine a taxpayers records to verify the accuracy of returns. Establishes the payment required from the business whose records are kept out of State when the department has to examine the businesses records.</p>
<p>22</p> <p>Section deleted in the revised filing of the initiative petition.</p>	<p>Requires the department to make available the name of a business and the amount of margin tax paid to any person who requests the information. The department is also required to post the information on its website and update the information within 30 days of any change.</p> <hr/> <p>—Currently the various taxes imposed under Chapter 32 of Nevada Revised Statutes do not provide for public identification of the taxpayer and what they pay in taxes except in very limited circumstances. Even gaming taxes paid by the various companies are aggregated for purposes of providing revenue information. This provision did not appear in SB 491, 1st reprint or AB 582. Even the Texas Margin tax does not have a comparable provision. Just what is the purpose of removing this provision?</p>

Association Opposes Taxation by Initiative

A survey of the Association’s Board of Directors determined by overwhelming opposition* to the initiative. NTA president, Carole Vilardo said the opposition to this initiative is not opposition to the importance of education, but is opposition to an initiative that has a number of problems, which will create unintended consequences if it qualifies and ultimately passes.

She said it is unrealistic to expect the imposition of this tax will not hurt Nevada’s economic recovery. Businesses that are struggling to stay alive will owe a tax that is not based on the ability to pay. And, to the extent that competition will allow the cost of this tax expense to be passed on to the public in the form of higher prices, individuals will also feel the impact of the tax.

Taxation by initiative, particularly when the tax proposed is paid “by the other guy” (business) and is married to a motherhood and apple pie issue (education) is not the way to craft tax policy. And, contrary to proponents’ claims it does not create a fair or equitable tax.

* 80% of the board responded and the vote was 96% to oppose the tax and 4% to support.

23-24 22-23	RATE AND TAXABLE MARGIN
23 22	<p>The rate is 2% of the taxable margin of the business for the taxable year.</p> <p>A business whose total revenue is \$1 million or less (as determined by section 25 24) is exempt from paying the tax.</p> <p>A passive entity as determined under section 18, or non-profit is exempt from paying the tax.</p> <p>A credit is allowed for payment of the modified business tax (MBT) paid for both general business and financial institutions.</p> <hr/> <p><i>The rate is 4 times higher than the Texas Margin tax for retail and manufacturing businesses and 2 times higher than the Texas rate for all other businesses.</i></p> <p><i>Many small businesses will be surprised to find that once they calculate total revenue pursuant to section 25, their revenue will total more than \$1 million because of the add-on provisions which include such things as dividends, rents, royalties, sale of non-capital goods, etc.</i></p> <p><i>SB 491 1st Reprint of the 2011 legislative session provided for all non-profits to pay the tax. AB 582 provided for only 501(c) (3) to be exempt, but this initiative exempts all nonprofits from paying the tax, including unions.</i></p>
24 23	<p>The taxable margin of a business entity, as calculated in section 28 27, is determined by taking one of the following three deductions:</p> <p>30% of the total revenue as determined under section 25 24; or</p> <p>The cost of goods sold as determined under section 26 25; or</p> <p>The amount of compensation, up to \$300,000 per employee, as determined under section 27 26.</p>
25-28 24-27	CALCULATING TOTAL REVENUE AND TOTAL INCOME
25 24	<p>Provides for the calculation of the total revenue of the business. Identifies the IRS forms and lines used on each return that must be used to determine total revenue. Generally this includes the amount of reported gross income (before returns/allowances, and the cost of goods sold) plus dividend, interest, rent, royalties, capital gains, the sale of other depreciable and non-depreciable property, and other income. Allowable deductions include, but are not limited to bad debts, foreign royalties and dividends, income from business entities taxed a partnerships, S Corporations and, disregarded entities (these entities are taxed separately unless unitary) etc.</p> <p>Exclusions from reporting include any pass-through revenue, repayment of the principal of loans from financial institutions, dividends and interest from government bonds or securities, gross gaming taxes paid, etc.</p> <hr/> <p><i>Again, many small businesses will be surprised to find that once they calculate total revenue pursuant to this section, their revenue will total more than \$1 million because of the add-on provisions. Additionally, because the \$1 million is not indexed, over time it will capture more and more small businesses, similar to what has happened with the federal alternative minimum tax.</i></p>
26 25	<p>Details what is allowed under the cost of goods sold and what is not allowed subject to section 28 27.</p> <hr/> <p><i>The cost of goods sold does not follow federal law and for purposes of audits will require a business to keep another set of books. It will be one of the most difficult provisions for businesses to determine.</i></p> <p><i>This has also been one of the most controversial provisions of the Texas Margin tax. In fact several lawsuits are pending in Texas by rental companies that cannot claim the cost of goods sold deduction because they are not sellers.</i></p>

<p>25-28 24-27</p>	<p align="center">CALCULATING TOTAL REVENUE AND TOTAL INCOME CONTINUED</p>
<p>27 26</p>	<p>Provides for the deduction of compensation and identifies what is and what is not allowed subject to section 28 27. Individual employee compensation over \$300,000 cannot be included in the deduction.</p>
<p>28 27</p>	<p>Requires combined (unitary) reporting of affiliated groups. Must not include a business entity that has 80% of its payroll and property is located outside of the United States, or 80% or more of the business entity's total income is from outside of the United States. Establishes the method for determining the total revenue that must be reported by the combined entity and how the provisions of sections 24 23 and 25 24 are to be treated.</p>
<p>29-32 28-31</p>	<p align="center">APPORTIONING MARGIN</p> <hr/> <p>There is insufficient information for service providers performing activities both inside and outside of Nevada and seller of intangible property to determine how their allocation is made. Just read the testimony for SB 491, 1st reprint from the 2011 legislative session to see some of the problems that will be faced by businesses that provide any level of service between the State and out-of-state locations. These issues were never addressed in AB 582.</p> <p>What are the underlying assumptions for these provisions.? Would this put the Tax Commission in the position of writing law as they did with the tax bills passed during the 2003 session?</p>
<p>29 28</p>	<p>Provides for the method of apportionment to account for the business entity's portion of total income that is attributable to Nevada.</p>
<p>30 29</p>	<p>Provides the apportionment sourcing rules subject to section 29 28.</p>
<p>31 30</p>	<p>Identifies additional items of income to be used in calculating the margin subject to section 29 28.</p>
<p>32 31</p>	<p>Requires the business entity to use the same method for apportioning margin as is used to calculate the margin.</p> <p>Does not allow a change in accounting methods more often than every 4 years and requires approval of department to change the method.</p> <hr/> <p><i>This was identified as a problem in SB 491, 1st reprint of the 2011 legislative session and not corrected in AB 582. A business may change its accounting methods by applying or notifying the IRS of the change. This is another instance, where a second set of books may have to be kept to satisfy state audits.</i></p>
<p>33-37 32-36</p>	<p align="center">RETURNS, PAYMENTS AND REFUNDS</p>
<p>33 32</p>	<p>The tax is due for each taxable year on the last day of the calendar month following that taxable year, and remitted with the return filed on a form required by the department. Filing is made under the penalty of perjury.</p>
<p>34 33</p>	<p>Upon a written application to the department an extension may be granted to the business if an extension is granted by IRS. Payment may be required as a condition of granting the extension. The department may grant an additional 30 day extension. No penalty or late charge will be added within the extension period, but interest will be charged at the rate of 1% per month unless otherwise provided in statute.</p> <hr/> <p><i>As a condition of granting the extension, most states and the federal government do not require payment to be submitted with the application for extension. Instead they provide for penalty and interest if you owe more than 10% of the tax due.</i></p> <p><i>Why is there a difference in interest rate between this section and the following section?</i></p>

33-37 32-36	RETURNS, PAYMENTS AND REFUNDS CONTINUED
35 34	<p>Any changes to a federal return due to amendment by the business entity, or because of audit or adjustment by IRS require the entity to file an amended return with the department. The department may assess a deficiency if it “appears” that tax is owed at an interest rate of 3/4% per month.</p> <p><i>See comment in section 33.</i></p>
36 35	<p>If the department determines that any tax, penalty or interest has been paid more than once, or erroneously collected or computed, it shall so certify to the State Board of Examiners. If approved by the Board the excess amount is to be credited against any other tax due. Any balance left after crediting is refunded.</p>
37 36	<p>A refund claim must be filed in writing within three years after the last day of the month following the taxable year for which an overpayment was made. No credit is allowed after that date. Within 30 days after rejecting a claim, the department shall serve notice upon the claimant the same as it would for a deficiency determination.</p>
38-46 37-45	REMEDIES FOR CLAIMS
38 37	<p>No legal action may be filed in a court in this state for an overpayment unless a claim for refund or credit has been filed.</p>
39 38	<p>Within 30 90 days of a decision rendered by the Tax Commission on a claim, an action may be brought against the department in a court of competent jurisdiction in Carson City or in a county where the relevant proceeding was conducted by the department.</p>
40 39	<p>A claim is considered disallowed if the department does not notify the claimant within 6 months. A claimant may file an appeal with the Commission within 30 days after the 6 month period. If a person is aggrieved by the Commission decision they may bring an action against the department.</p>
41 40	<p>If the court determines the department acted arbitrarily or capriciously, interest on the refund is at the Federal Funds Target Rate, but not more than 6% per year.</p> <p><i>Why is interest granted only if a court determines that the department acted arbitrarily or capriciously?</i></p> <p><i>Why wasn't the IRS interest rate for refunds and under payments and over payments used instead? Could it be because like so many other issues identified with this initiative they weren't vetted?</i></p> <p><i>And, why shouldn't interest be paid if it is the taxpayer who identifies an overpayment, which the department confirms is accurate as the department is required to do on all other taxes?</i></p>
42 41	<p>A judgment may not be awarded if the action is brought by an assignee or any person other than the person that paid the amount.</p>

Initiative Fast Facts . . .

- ☞ A statewide total of 72,352 valid signatures must be collected in each of the four petition (Congressional) districts.
- ☞ Signatures must be turned into the various County Clerks by November 13, 2012.
- ☞ If sufficient signatures are collected, the initiative is introduced the first day of the 2013 legislative session.
- ☞ The Legislature must act on the initiative within the first 40 days of the 2013 legislative session.

For additional information visit the NTA website to read the special electronic edition of *Tax Topics*, June 2012 issue, which summarizes the various processes and time frames for statutory initiatives in Nevada.

38-46 37-45	REMEDIES FOR CLAIMS CONTINUED
43 42	The department may recover an erroneously allowed refund or credit, in part or whole, by filing an action in a court of competent jurisdiction in Carson City or Clark County. The action is prosecuted by the Attorney General.
44 43	Any amount in excess of \$25 that has been illegally determined may be refunded if approved by the State Board of Examiners. If the amount does not exceed \$25, the department may cancel the amount from its records without approval from the State Board of Examiners.
45 44	A person is guilty of a gross misdemeanor if they make any false or fraudulent return or declaration or state; make, cause or permit any false entry in the books, records or accounts of the business; keep or cause to be kept more than one set of books with the intent to defraud the State.
46 45	Remedies of the State in this chapter are cumulative and no remedy may be pursued to the exclusion of any other remedy by the Department or Attorney General.
47-79 46-78	MISCELLANEOUS PROVISIONS
47 Deleted	<p>Adds the conforming language to provide the exception to the confidentiality provisions in NRS 360.255:</p> <p style="text-align: center;">_____</p> <p style="text-align: center;"><i>See section 25 this write-up.</i></p>
48-51 46-49	Conforming language to reference sections 3-46 in Title 32 of NRS (Revenue and Taxation).
52 50-52	<p>Changes the Modified Business tax rate for Financial Institutions from 2 % to 2.24 % 2.29% effective on July 1, 2013 if the Legislature approves the initiative. If the legislature does not approve the initiative the rate imposed is and 2.42%, effective on July 1, 2015. The increase sunsets June 30, the year after imposition.</p> <p style="text-align: center;">_____</p> <p style="text-align: center;"><i>This increase is used to provide funds to the department for the purpose of paying for the initial costs of administering the tax. See sections 80 and 81.</i></p>
53	Provides an exclusion to NRS 78.245 (Corporate stocks, bonds and securities not taxed when owned by nonresidents or foreign corporations.)
54-72	Conforming language. References sections 3-46 in various statutes relating to the examination of records, information provided to, and the examination of records by the department of taxation, etc.
73	Provides an exclusion from provisions contained in “Insurance Taxes and Fees” (NRS 680B.037) to allow the imposition of this tax.
74- 79	Conforming language to various other insurance statutory cites.
80	If the Legislature approves the initiative an appropriation is provided from the State’s General Fund for FY 2013-2014 and 2014-2015 of \$2.5 million each year , \$2.9 and \$2.7 million respectively, although the sums are available for either year.
81	If the Legislature does not approve the initiative, but the voters do an appropriation is provided from the State General Fund for FY 2014-2015 of \$1,250,000 \$1.4 million and for FY 2015-2016 of \$3,750,000 \$4.2 million, although the sums are available for either year.
82	Earmarks the revenue raised by the Modified Business Tax - financial institutions (sections 51 and 52) to fund the appropriations made in sections 80 and 81.

83-84	EFFECTIVE DATES AND SEVERABILITY
83	<p>Specifies the effective dates if the act is approved by the legislature and the Governor:</p> <p>July 1, 2013 for sections 1-22, 24-80, and 82.</p> <p>January 1, 2014 for section 23; section 81 does not become effective; and the amendatory provisions of section 52 expires by limitation on June 30, 2015.</p> <p>If not approved by the legislators, but approved by the voters the provisions are effective as follows:</p> <p>January 1, 2015 for sections 1-79 and 81-82; section 80 of the act does not become effective; and the amendatory provisions of section 52 expire by limitation on June 30, 2016.</p>
83(sic) 84	<p>Severability clause. “If any provision of this act or its application to any person or circumstance is held to (sic) invalid or ineffective, that invalidity or ineffectiveness must be given the narrowest possible construction and shall not affect any other provision or application of this act.”</p>

TAX TOPICS

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