State and Local Tax Roundup
Retail and Consumer Industry

October 2013

Insights exploring state and local tax issues affecting retailers

Highlights

What are the unique state and local tax issues and potential opportunities facing retail and consumer businesses?

- *Missouri bad debt deduction sales tax win*
- *New Jersey incentives opportunities*
- *New York City commercial rent tax risk*
- *Recent decisions regarding the deductibility of management fees in Indiana and Virginia*

Missouri retailer receives bad debt refund on amounts written off by third party

In a case of first impression, the Missouri Administrative Hearing Commission found that a retail merchant was entitled to a sales tax refund for bad debts written off by its private label credit card bank. Missouri law does not expressly require that the entity requesting the refund be the entity that writes off the bad debt. The Commission found that the retailer and bank, acting as a unit, satisfied the requirements that allowed the merchant to qualify for a bad debt refund.

Missouri retailers that issue private label credit cards should be aware of potential bad debt refund opportunities consistent with the rationale provided in this decision.

For further details, please click here for our Insight, released October 4, 2013.

New Jersey retailers qualify for incentives under Opportunity Act of 2013

Effective September 18, 2013, the New Jersey Opportunity Act of 2013, A.B. 3680, expands two Economic Development Authority programs, including the Grow New Jersey Assistance Program. Historically, retailers were generally ineligible for benefits under the program. However, under A.B. 3680, the following facilities may qualify for benefits under the program:

- up to 7.5% of retail facilities included in a mixed-use project located in certain zones; or
- a retail facility of at least 150,000 square feet, of which at least 50% is occupied by a full-service supermarket or grocery store, located in certain zones.

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New York retailers subject to commercial rent tax

Retailers should be aware of an often-missed tax imposed on the occupancy of commercial premises in Manhattan south of 96th street at the effective rate of 3.9% of base rent. Taxable premises are typically traditional office and retail space but can include any premises occupied, used, or intended to be occupied or used in carrying on any trade or business. New York City imposes a maximum 47.5% penalty on a taxpayer's failure to file and pay the tax. There are also statutory penalties for negligence (5% of the underpayment plus 50% of the interest on the underpayment) and for the substantial understatement of tax (10%). Affected retailers not remitting the commercial rent tax should consider their options for getting in compliance with the tax.

New York City's commercial rent tax is a relatively unknown tax with significant penalties for noncompliance. The tax is often missed by retailers, especially those that are not based in New York City.

Read PwC's briefing for further details and insight into the risk New York City retailers face concerning the commercial rent tax.

Recent transfer pricing decisions regarding the deductibility of management fees

In a recent Letter of Findings, the Indiana Department of Revenue disallowed a portion of management fees composed of 'residual profits' that were paid to an affiliated company. The Department determined that the taxpayer's deduction for fees paid in excess of the affiliate's actual expenses (which were returned to the taxpayer as dividends) did not result in a fair reflection of the taxpayer's Indiana income.

Indiana retailers should be aware that the state may exercise its IRC sec. 482-like powers to disallow a portion of a taxpayer's related company management fee expense.

In contrast, in a Virginia Department of Taxation Commissioner Ruling, a taxpayer incurred related party franchise fees, which the Commissioner viewed as management fees. The taxpayer provided several independent transfer pricing studies demonstrating that the charges were reasonable when compared with arm's length transactions between unrelated parties.

The Commissioner determined economic substance was clear and services were provided at fair market value and, therefore, allowed the taxpayer to deduct its franchise fees.

This Virginia ruling affirms that related party management/franchise fees may be sustained on audit when supported by a transfer pricing study that evidences an arrangement between related parties that does not distort Virginia taxable income and is provided at fair market value.

For further details regarding Indiana's decision to disallow management fees, please click here for our Insight, released August 22, 2013.

For further details regarding Virginia's decision to allow a deduction for management fees, please click here for our Insight, released August 9, 2013.

Let's talk

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