KILPATRICK TOWNSEND

4 KEY TAKEAWAYS

Practical Insights on New Tax Issues

On March 23rd, Kilpatrick Townsend Tax Partners Lynn Fowler, Heather Preston, and Jeff Reed participated in a webinar hosted by the firm called Practical Insights on New Tax Issues. The webinar discussed recent issues arising in practice.

Here are 4 key takeaways from the webinar:

1

Taxable Stock Acquisitions – Treatment of PPP Loans

Many target companies took PPP loans in 2020 as a means to provide liquidity during the earliest periods of the pandemic. If those loans have not already been forgiven, the SBA rules requires lender approval if the target undergoes a "change of ownership." To obtain lender approval, the target must have submitted an application to forgive the loan and agrees to escrow with the lender the balance of the loan. Depending on the treatment of the escrow between the buyer and the target shareholders, the escrowed amount could be characterized:

- A reduction of the amount realized by the target shareholders, if the loan is treated as indebtedness of the target and reduces purchase price in all events;
- Contingent additional purchase price potentially subject to installment sale treatment, if an amount equal to any amount of the PPP loan balance ultimately forgiven is later paid to the target shareholders; or
- An indemnification claim giving rise to a capital loss under the Arrowsmith doctrine, if an amount equal to the PPP loan balance the target shareholders is later paid to the buyer upon a determination that the PPP loan will not be forgiven.

2

Taxable Stock Acquisitions – Treatment of Payroll Tax Deferral

Most target companies have taken advantage of the CARES Act provisions allowing for the deferral of the employer portion of payroll taxes through the end of 2020. Any deferred amounts are due 50% by December 31, 2021 and 50% by December 31, 2022. In most cases, the deferred taxes will be treated as target indebtedness reducing the purchase price paid to the target shareholders and likewise the shareholders' amount realized. However, in some cases the parties could treat the indebtedness as a pre-closing tax subject to indemnification when due. If the indemnification occurs in a year after the closing of the stock sale, the payment will most likely give rise to a capital loss under the *Arrowsmith* doctrine.

3

COVID Dislocation Issues are Arising in Many SALT Contexts

As a result of the pandemic, many employees remain away from offices, in some cases working in new states. This is expected to continue for at least a few months, plus some employers have permanently changed their telework policies to permit more regular working from home policies after the pandemic ends. What does this mean for state taxation? Many employers will have to consider registering to do business in new states, with all that entails, including potential income-tax withholdings, income tax filings, and sales and use tax registration in new states. Some service-based businesses may receive an apportionment benefit from workers in new states: this is because some jurisdictions still source services based on where they are performed, meaning services may be performed in new states, thereby lowering receipts sourced to office jurisdictions. A note of caution for those seeking to switch their state of tax residency due to the pandemic: many states have a statutory concept of "domicile," or "permanent home," and it may be difficult to show that a pandemic-induced move to a new state resulted in a change of domicile if there is a subsequent return to the first state once the pandemic ends. All and all, as the above issues and others demonstrate, movement to new states due to the pandemic is resulting in lots of new issues for taxpayers to think through.

4

Sales Taxes Imposed on Online Services Is a Hot Audit Issue and Deal Issue

States continue to expand their sales tax bases by imposing sales tax on services provided online using computer software. Some states are also targeting new services that might not have been considered taxable just a couple years ago. For example, New York is now taking the position that cybersecurity services are not taxable sales of software, but are rather taxable sales of "protective or detective services." What are the consequences of increased sales taxation on online services? First, for sellers of such services, they must make difficult decisions about where to file; they also should consider potential letter ruling requests. For larger companies acquiring smaller tech companies, consideration must be given to how to handle potential seller sales tax filing errors as part of the deal, which could mean, for example, a reduction in purchase price or a provision requiring the seller to obtain voluntary disclosure agreements to clean up past exposure at its own expense. Even for companies that are not selling online services or looking to purchase tech companies, they still will want to consider the impact of the issue from a use tax perspective when purchasing online services from third-parties.

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