RYP TAX ALERT

June 2019

KEY VERMONT TAX LEGISLATION ENACTED

In the month of June, Governor Phil Scott (D) signed into law several bills containing significant tax law changes that will impact many entities engaged in business in Vermont. Kathryn Michaelis and Chris Sullivan of RYP's Tax Practice Group, both Vermont tax lawyers, provide a brief highlight of the more significant changes.

CORPORATE INCOME TAX: MARKET-BASED SOURCING FOR SERVICE RECEIPTS

Following the national trend, and added on late in the legislative session, Act 51 (H. 514, Sec. 8) shifts sourcing of service receipts to the sales factor from a "cost of performance" method to a "market-based sourcing" method for Corporate Income Tax purposes. Under prior law, receipts from the provision of services were included in the taxpayer's sales factor numerator of the apportionment formula based upon the location of the income-producing activities using a cost of performance approach. Under the new law, service receipts are instead to be included in the taxpayer's sales factor numerator based on the location of the taxpayer's market for the services. *See* 32 VSA § 5833.

For example, a service business with its sole office and employees located in New Hampshire that provides services to customers in Vermont formerly would have sourced those sales to New Hampshire, whereas the new law will require those receipts to be sourced to Vermont. Because New Hampshire remains a "cost of performance" state, the New Hampshire business would have the same receipts sourced to two different states, effectively causing an increased tax cost. However, it is worth noting that New Hampshire is very likely to adopt market-based sourcing for the 2021 tax year, so that all New England states will have completed the shift from cost of performance to market-based sourcing.

Additional provisions further identify the taxpayer's market for specified sales, rules of reasonable approximation when the market cannot be ascertained, and circumstances for the exclusion of sales from the sales factor. The new law is effective for tax years starting after January 1, 2020. It is anticipated that a technical corrections bill will clarify the intent of the legislation to be for tax years on or after January 1, 2020, but at the time of this article, no formal guidance has been issued.

CORPORATE INCOME TAX STUDY: ISSUES ON THE HORIZON

In addition to the shift to market-based sourcing, Act 51 (H. 514, Sec. 9) requires a corporate income tax study to be completed by December 15, 2019. The report is to analyze several issues relating to potential changes to the corporate income tax, including: a shift from a three-factor formula to a single sales factor formula; elimination of the exclusion of "overseas business organizations" (80/20 companies) from a combined group; shifting banking institutions out of the bank franchise tax and into the corporate income tax; and focusing on capturing corporate economic activity for corporations who have little to no taxable income.

The report reflects an effort to modernize the corporate income tax code and foster economic development in the state, as well as the last issue perhaps reflecting a nod to neighboring New Hampshire's decades-old Business Enterprise Tax, which is a VAT-style tax.

PERSONAL INCOME TAX: CAPITAL GAIN EXCLUSION CAP

Act 71 (H. 541, Sec. 1) includes a flat cap to the capital gain exclusion for individual income tax purposes, including partnerships and LLCs doing business in Vermont that have individual owners. Under prior law, an individual, estate or trust was permitted to claim a 40% exclusion of net capital gains reported federally. Under the new law, a taxpayer is permitted to exclude the capital gain income so long as it does not exceed the lesser of 40% of federal taxable income or $350,000. *See* 32 VSA § 5811(21),(28). The new law is effective on July 1, 2019 and applies to sales of assets on or after that date.

MEALS AND ROOMS TAX: EXPANSION TO ONLINE TRAVEL COMPANIES

Act 71 (H. 541, Sec. 7) expands the Meals and Rooms Tax ("M&R") to include online travel companies as "operators" responsible for the collection of the M&R Tax. Under prior law, only hotels were subject to the M&R Tax as operators. Under the new law, an operator includes a "booking agent," which is defined in part as "a person who facilitates the rental of an occupancy and collects rent" and who offers, reserves, books arranges for, remarkets, distributes, brokers, resells or facilitates an occupancy at a hotel "through an Internet transaction or any other means." *See* 32 VSA §§ 9202 *et seq.* The legislation was likely in response to the wave of lawsuits by numerous states and municipalities that have been almost entirely unsuccessful in their attempts to require online travel companies to collect and remit tax and include their fees in the tax base under similar "operator" statutes. The new law is effective July 1, 2019.

SALES AND USE TAX: MARKETPLACE FACILTIATORS

Following the post-*Wayfair* national trend, Act 46 (H. 536, Secs. 3-4) creates sales and use tax collection and remittance requirements on out-of-state "marketplace facilitators" who have facilitated sales by "marketplace sellers" to destinations within Vermont of at least $100,000 or totaling at least 200 individual transactions during any 12-month period. Out-of-state marketplace sellers making combined sales to Vermont and through a marketplace to Vermont are also required to collect and remit sales tax on those sales if those same thresholds are met. The new law is effective June 1, 2019, resulting in the first return filing and payment due July 25, 2019.

PROPERTY TRANSFER TAX: CONTROLLING INTEREST TRANSFERS

Act 71 (H. 541, Sec. 9) amended the Property Transfer Tax to expand the tax from title transfers to also include transfers of "controlling interests" in certain entities that own title to the real property. Under prior law, the tax only applied to transfers of title to property. Under the new law, the tax will also include a transfer "of a direct or indirect controlling interests in any person with title to property," with a "person" being redefined to include national persons, associations, trusts, corporations, partnerships, limited liabilities or other legal entities. A "controlling interest" is defined generally as 50% or more of the voting power or 50% or more of the capital, profits, or beneficial interest in such entities. Additional provisions explain how to calculate the controlling interests when persons are acting in concert. The new law exempts transfers to effectuate a mere change in identity in form when no change in beneficial ownership occurs, as well as retaining current exemptions that apply to direct title transfers. *See* 32 VSA §§ 9601 *et seq*. The new law takes effect on July 1, 2019.

Notably, on its face, the new law is not limited to transfers in real estate holding companies, and as a result, the tax may apply any time an operating entity that owns real estate transfers 50% or more of its interests. The broad-reaching scope of the new law stands out from many other states with similar property transfer taxes. The Department is expected to address the complications surrounding the new law and will be seeking input from practitioners and affected companies.

MISCELLANEOUS TAX PROVISIONS

Additional tax law changes were enacted by both bills, including those relating to: reporting for publicly-traded partnerships (Act 51, Sec. 11), sales for resale under the Meals and Rooms Tax (Act 51, Sec. 12), the Land Gains Tax (Act 71, Sec. 16), changes to interest on overpayments (H. 514, Sec. 2), and changes to the recapture of the federal investment tax credit (Act 51, Sec.4).

For inquiries or comments relating to these Vermont law changes, please contact Kathryn at khm@rathlaw.com or Chris at cjs@rathlaw.com. Both Kathryn and Chris have extensive experience in state and local tax matters in Vermont, New Hampshire and Massachusetts. For more information about the RYP Tax Practice, please visit: www.rathlaw.com/practice-areas/tax.