NEVADA MARGIN TAX – PROPOSED AMENDMENT 6801 TO SENATE BILL 491

The proposed amendment to Senate Bill 491 creates a new broad-based business tax at a rate of 0.8 percent of the taxable margin of a business, effective July 1, 2012. The tax would apply to those businesses whose total revenue exceeds $1 million per year. Businesses under this threshold, as well as sole proprietorships, general partnerships owned directly by natural persons, and non-profit organizations are excluded from the tax.

The Nevada Margin Tax is computed by determining an entity’s total revenue, which is then used to calculate the entity’s margin – the lesser of total revenue minus cost of goods sold, total revenue minus total compensation paid, or 70 percent of total revenue. The business then will apportion to Nevada the amount of margin from business done in the state and will subtract any other allowable deductions to determine the entity’s taxable margin in the State.

Once the business’s taxable margin is determined, a rate of 0.8 percent is applied to that margin to determine that entity’s liability.

**Calculation of Nevada Margin Tax**

There are four steps that a business must take in order to determine its liability for the Nevada Margin Tax:

1) **Determination of Total Revenue**

Total revenue includes:

- Total income less returns, as reported to the Internal Revenue Service on its federal income tax return;
- Rents;
- Royalties;
- Interest; and
- Other income specified in Section 35 of the bill.

Less:

- Bad debt;
- Foreign royalties;
- Foreign dividends;
- Gross proceeds that are subject to the Net Proceeds of Minerals Tax;
- Medicare, Medicaid, and other revenue received from government entities by health care providers and hospitals; and
- Other exclusions specified in Section 35 of the bill.

If total revenue is less than $1 million for a taxable year, then no liability exists for the entity.
2) Determination of Margin

Margin is the lesser of the following calculations:

- **Total revenue less cost of goods sold.** Costs of goods sold include any expenses directly related to the manufacture of goods, including the costs of materials and the direct labor costs used to produce the goods. Cost of goods sold would not include expenses related to shipping costs, compensation of officers, selling costs, marketing, or other business expenses not directly related to the cost of producing the goods that are sold by the business, or

- **Total revenue less compensation paid.** Total compensation is the amount of wages, retirement benefits and health care benefits paid to its employees and officers. Other deductions not related to the wages and compensation of employees and officers may not be taken; or

- **70 percent of total revenue.** A standard deduction of 30 percent of total receipts may be used, instead of taking a deduction for the cost of goods sold or total compensation.

Because the business may use the deduction that results in the lowest margin for that business, it may perform any or all of these calculations in order to determine which method of taxation results in the lowest margin and smallest liability.

- **EXAMPLE 1:** A business whose total revenue is $1 million, and who has a cost of goods sold of $500,000 and total compensation of $200,000, may deduct cost of goods sold, as that deduction would result in the smallest margin ($500,000, as opposed to $800,000 of margin that would result from deducting total compensation).

- **EXAMPLE 2:** A business whose total revenue is $1 million, with a cost of goods sold of $100,000 and total compensation of $200,000, may use 70 percent of total revenue as its margin, as that calculation would result in a smaller margin ($700,000) than either compensation ($800,000) or cost of goods sold ($900,000).

3) Determination of Nevada Taxable Margin

The calculation of margin in steps 1 and 2 uses total revenue, cost of goods sold, and total compensation for the business on a worldwide basis. The business must apportion its margin to Nevada to reflect only that amount of margin attributable to the State of Nevada.

Section 39 of the bill requires that the apportionment factor to be used to determine Nevada taxable margin is based wholly on total income in Nevada as a percentage of total income for the business. This percentage is applied to the margin to determine Nevada taxable margin.
Total income in Nevada is defined in Section 40 for this purpose as the total receipts from the sale of tangible personal property; performance of services; rental of property; the use of patents, copyrights, trademarks, franchises, or licenses; the sale of real property, including royalties from oil, gas, or other mineral interests; and any other business done in Nevada.

**EXAMPLE:** If a business with $1 million in total revenue and $500,000 in margin generated $100,000 of its total revenue in Nevada, its apportionment factor would be 10 percent, or $100,000/$1,000,000. The business would, therefore, report Nevada taxable margin of $50,000, or 10 percent of $500,000.

4) Application of the tax rate to determine total liability

Section 33 requires the payment of a rate of 0.8 percent of the Nevada taxable margin reported by the business.

**EXAMPLE:** A business with a Nevada taxable margin of $50,000 would be liable for a payment equal to $400.

**Due Date for the Tax**

Section 43 of the bill requires the tax to be paid, along with the return required by the Department of Taxation, no later than 30 days after the business files its federal income tax return with the Internal Revenue Service.

If the business files an extension with the IRS, Section 44 allows the business to also receive an extension of the time for which the Nevada Margin Tax must be paid, such that the new due date for the Nevada Margin Tax is 30 days after the due date of the federal return after the extension has been granted.

**Entities Subject To Nevada Margin Tax**

Section 14 of the bill defines a “business entity” that is subject to the Nevada Margin Tax as:

- Corporations;
- Partnerships;
- Proprietorships;
- Limited-liability companies;
- Business associations;
- Joint ventures;
- Limited liability partnerships;
- Business trusts;
- Professional associations;
- Joint stock companies;
- Holding companies; and
- Any other person engaging in a business.
Entities excluded from the tax include:

- Sole proprietorships;
- Governmental entities;
- Nonprofit companies; and
- Any other person or entity that is prohibited from being taxed under federal or state law.

**Deduction for Cost of Goods Sold**

Section 36 of the bill specifies that cost of goods sold includes the direct costs of acquiring or producing real property or tangible personal property sold in the ordinary course of business by a business entity. These costs include:

- Labor costs;
- The cost of materials that are an integral part of the specific property produced;
- The cost of materials consumed in the ordinary course of production;
- Handling costs; including costs attributable to processing, assembling, repackaging, and transportation of goods to the business entity;
- Storage costs;
- Depreciation, depletion and amortization, as reported on the federal income tax return, to the extent that these costs are associated with and necessary for the production of goods;
- The cost of renting or leasing equipment, facilities, or real property directly used for the production of goods;
- The cost of repairing and maintaining equipment, facilities, or real property directly used for the production of goods;
- Costs attributable to research, experimental, engineering, or design activities directly related the production of the goods;
- Geological and geophysical costs incurred to identify and locate property that has the potential to produce minerals;
- Taxes paid in relation to acquiring or producing any material, and taxes paid in relation to services that are a direct cost of production; and
- The cost of producing or acquiring any electricity sold.

A business may also deduct the following costs relative to the goods of the business entity:

- Deterioration;
- Obsolescence;
- Spoilage and abandonment, including the costs of rework labor, reclamation, and scrap;
- Direct costs of preproduction allocable to the property (if the property is held for future production);
- Direct costs of postproduction allocable to the property;
- Insurance costs on any plant, facility, machinery, equipment, or materials directly used in the production of the goods;
- Insurance costs on the produced goods;
- Utility costs, including electricity, gas, and water, directly used in the production of goods;
- Quality control costs; and
- Licensing and franchise costs.

Costs specifically excluded from the cost of goods sold include:

- Costs related to renting or leasing equipment, facilities, or real property not used for the production of goods;
- Selling costs;
- Distribution costs;
- Advertising costs;
- Rehandling;
- Costs related to bidding for contracts;
- Interest,
- Other income taxes;
- Strike compensation; and
- Compensation of officers.

**Deduction for Total Compensation Paid**

Section 37 of the bill specifies that compensation that may be deducted, in computing the margin for the business, includes all wages and cash compensation paid by the business entity to officers, directors, owners, partners, and employees. “Wages and cash compensation” includes the following payments:

- The amount entered in the Medicare Wages and Tips box of the Internal Revenue Service Form W-2;
- Net distributive income from business entities treated as partnerships for federal income taxation, if the person receiving the distribution is a natural person;
- Net distributive income from S corporations and limited liability companies, if the person receiving the distribution is a natural person;
- Net distributive income from limited liability companies taxed as sole proprietorships, if the person receiving the distribution is a natural person; and
- Stock awards and stock options deducted for the purposes of federal income taxation.

Total compensation also includes the cost of all benefits, to the extent deductible for the purposes of federal income taxation, that are provided to officers, directors, owners, partners, and employees, including retirement, health care, employer contributions to health savings accounts, and workers’ compensation benefits.

Regardless of the amount of wages and compensation paid, the business entity may not claim more than $300,000 in wages and cash compensation per employee per year.
Credit Allowance for Modified Business Taxes Paid

Section 33 allows any business who pays the Modified Business Tax on Nonfinancial Institutions or the Modified Business Tax on Financial Institutions to take a credit against their Margin Tax liability in the amount of these taxes paid during a taxable year. The amount of credit taken may not exceed the Margin Tax liability.

- **EXAMPLE 1:** A business whose calculated Margin Tax liability for their taxable year is $500, but who paid $200 in Modified Business Tax during that period, may take a $200 credit against their Margin Tax liability. The business is required to pay only $300 in Margin Tax.

- **EXAMPLE 2:** A business whose calculated Margin Tax liability for their taxable year is $500, but who paid $1,000 in Modified Business Tax during that period, may only take the credit to the extent of their liability. The business would not be liable for any Margin Tax for that taxable year; however, the excess $500 credit from Modified Business Tax payments may not be carried over to a subsequent taxable year.

Additional Reporting Requirements For Businesses

Section 132 requires each business entity whose taxable year ends between June 30, 2011, and May 31, 2012, to report the following information to the Department of Taxation, on a form approved by the Department, for that taxable year:

- The principal business activity code reported on the entity’s federal income tax return;
- The business entity’s total revenue;
- The business entity’s cost of goods sold;
- The business entity’s total compensation;
- The business entity’s total income from business done in Nevada; and
- The business entity’s total income from its entire business operations.

This information must be submitted to the Department no later than January 31, 2012, or 30 days following the filing of the entity’s federal income tax return, whichever is later. The business entity is not required to calculate any liability for the Margin Tax based on this information, nor is there a requirement to pay any Margin Tax based on this information.

Distribution of Margin Tax Proceeds

Section 28 requires that the proceeds of the tax, including penalties and interest, be deposited in the State General Fund.

For Fiscal Year 2013, Section 134 requires that any Margin Tax revenue collected in excess of the estimates prepared by the Fiscal Analysis Division be distributed as follows:
• The State Controller must ensure that the transfers made to the Fund to Stabilize the Operation of the State Government (or “Rainy Day Fund”) are made pursuant to NRS 353.288.

• If any proceeds are remaining after this transfer is made, 2 percent of the remaining proceeds must be used to reduce the unfunded liability of the Public Employees’ Retirement System.

• All other remaining proceeds are to be transferred to the unrestricted balance of the State General Fund.

**Rate Changes For Modified Business Tax on Nonfinancial and Financial Institutions**

The provisions of the amendment extend the sunset for the two-tiered rate for the Modified Business Tax on Nonfinancial Institutions from June 30, 2011, until June 30, 2013. The two-tiered rate structure of 0.5 percent on all wages up to $62,500 per calendar quarter and 1.17 percent on wages exceeding $62,500 per calendar quarter was originally approved as a result of Senate Bill 429 of the 2009 Session for the 2009-11 biennium. Effective July 1, 2013, this tax is completely repealed.

The provisions of the amendment also lower the rate for the Modified Business Tax on Financial Institutions from 2 percent to 1.17 percent, effective July 1, 2012. Like the tax on nonfinancial institutions, the Modified Business Tax on Financial Institutions is also repealed effective July 1, 2013.

**Repeal of Branch Bank Excise Tax**

Subsection 2 of Section 130 of the bill repeals the Branch Bank Excise Tax, effective July 1, 2011. This tax, which imposes a tax of $1,750 per quarter on banks for each branch operated in the State with an exemption for the first branch operated by a bank in each county, was created pursuant to Senate Bill 8 of the 20th Special Session (2003).

**Removal of Sunset for Business License Fee Increase**

Section 130 of the bill removes the June 30, 2011, sunset for the $100 per year increase of the Business License Fee approved pursuant to Senate Bill 429 and Senate Bill 435 of the 2009 Session, continuing the imposition of the $200 per year fee effective July 1, 2011.