STATE AND LOCAL TAX

Revenue Sourcing Analysis

If your business provides services to customers in multiple states, be wary of the opportunities and pitfalls that may result from different state tax treatments. Not all states source service revenue in the same manner, in fact state law varies wildly and is highly fact dependent. Apportioning tax by the location of service revenue is a headache, since you must consider the intricacies of your business and the complexity of state sourcing rules. For instance, you might have a customer office in one state, overseeing a contract service provider in a second state, performing work on a contract in yet other states. That same contract might cover both the sale of tangible personal property and the performance of services. How can you be sure your multistate business is accurately reporting service income and paying the right amount of tax to the correct states?

Cherry Bekaert Can Ensure You Are Accurately Reporting Service Income

These complex and varying approaches adopted by the states to apportion service income demand a more detailed look. In order to minimize overall state tax liability, sound tax planning for a multistate business is essential for understanding and using these complexities to your advantage. Failing to consider these complex and varied approaches to service income apportionment guarantees your business one of two outcomes: an inflated state tax liability or unanticipated exposure.

Our experienced SALT professionals will perform a detailed analysis to determine the applicable sourcing rules for your multistate business. We will then accurately determine the numerator of each state's sales factor and ensure that you are not under or over reporting revenue for state tax compliance purposes.

State Approaches to Sourcing Service Revenue

States generally use one of the following approaches to determine the amount of service revenue attributable to a given jurisdiction. Within each of these approaches, state law varies widely on the application of these rules.

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"Cost of Performance" method

Using this method, revenue is often attributed to a state if (a) all the costs of performing either services or other income-producing activities are incurred in the state; or (b) if the majority of the cost of performing either services or other income-producing activities is occurring in the state, when more than one state is involved. In other words, when a service is performed in multiple states, revenue is sourced to the state in which the greatest proportion of direct costs were incurred or where the majority of the work was performed. This is often referred to as the "all-or-nothing" approach and is applied differently among states.

"Pro Rata" method

This method aims to distribute revenue generated from services performed in multiple states based on costs incurred or time spent in each state. For example, a ratio of time physically spent in a state versus the total time spent on the contract is often used to divide revenue. There are many other complexities involved in applying these rules that need to be considered. Personal service income tends to follow a "pro rata" method even in "cost of performance" states. A personal service is generally one where a significant amount of capital is not required to perform the service.

"Market-Based" method

The growing trend among states is to look where the benefit of the service is being received, or the customer's location, in sourcing revenue. As you can imagine, complexities immediately arise with this approach when your contract includes services that are received in multiple locations. These complexities may be addressed by state-issued guidance in some instances, but there are significant differences in how the rules are applied among states employing this method.

We Can Guide You Forward

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