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# Tax Issues for Private Companies

Strengthening your business | September 2023

**Erika Whitmore:**

Alright. Well, Jeff, super excited to have you on the podcast today. I don't think people love to talk about taxes, but they are pretty scary at the same time, and so I always tell my clients that I will call one of my favorite tax folks, which is you, to talk about what we wanna stay out of the penalty box on. So with that if you could give us just a little bit of your background and introduce yourself.

**Jeff Worlton:**

Sounds great. Thanks, Erika, and everyone's favorite topic of taxes. Yeah, gotta love it so my name is Jeff Worlton. I am a partner in our Federal tax practice situated in Denver, Colorado, and I've been gosh! I've been at this for 25 years now. Primarily serving private and public entities very heavily involved within the high growth space for companies as well really love advising in that particular area of clients and just love rolling up my sleeves and getting involved with everybody that's involved with the emerging growth and high growth companies. I also consult with multi national type of companies. I lead different groups, multi discipline tax groups within the market to help advice clients on anything from a domestic or an international perspective. Try to solve problems why they come up for companies and, otherwise just love to serve my clients that are out there.

**Erika Whitmore:**

Awesome, awesome. Well, thank you, Jeff. I hope a lot of our listeners already know who you are, and if not, they will, after this, and maybe one other plug. There are so many different areas of expertise within tax. And, Jeff, I'm sure you'll talk about that a little bit. But you know, I think your technical expertise is fed tax. But technically, you know enough to be dangerous across the board and we also know when to pull in other experts when needed, which is often so, that's kind of maybe just the lay of the land. So in preparing for this podcast we really wanted to focus on. You know, those areas that we feel like we see high growth companies, or really any that can cause, you know, undo pain right? And whether you're looking to go public some day, whether you know you are thinking in, you know, 3 to 5 years you might get bought, whatever the case may be. Right? You don't want, Jeff as you said, in our planning meeting skeletons in the closet. Right? So we're trying to avoid the scariest skeletons in the closet. So there's a handful of topics we're gonna talk about today. But the first one is going to be remote, slash, hybrid workers. So so maybe, Jeff, if you can kind of give us, you know biggest things to watch out for when it comes to those types of workers.

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**Jeff Worlton:**

You bet. So you know, this is an interesting topic, because the pandemic really heightened the potential shortcomings that companies could find themselves in when it comes to State and local taxes, just by having a shift in where its employee base is performing services or performing the work for the company. So, as you guys realize or recognize before, the pandemic, you know, we were spread out to an extent from an employee standpoint, a lot of in office type of work going on. Then we send everybody home when the pandemic started. And what we found is over that, you know, 18 to 24, 30 month period was that employees by working remotely or in a hybrid and type environment. They kind of figured out that they don't necessarily need to stick around where they were currently living. They actually go out to a different state and actually move there and still get the work done that they need to do for their particular company. And a lot of companies were kind of aware of this. The HR Department which typically takes care of payroll function for a company, was somewhat aware of that, at least initially. But we found is that a lot of companies didn't take the time to actually try to determine where their employees were actually living. And what that does is it kind of screws up your state tax footprint because you may pool a recognition event for taxes, so to speak, in that if you have an employee that used to live in Colorado, but now lives in Tennessee. And you've got a handful of employees that actually decide to move to Nashville, because it's a cool place to be and the company had never actually filed a tax turn in Tennessee before. Well, just by having employees in that particular state jurisdiction. It may force you to file income tax returns there for the company. And I'm talking about corporate structures. And so it's interesting. I had one of my one of my companies that I recently engaged to do tax compliance work for, they had their Federal return, and they, I think they had about 5 state tax returns that we were gonna prepare for.

And we inquired about where the employee base was and had them actually pull some different information out of their system, just to kind of see where everyone's located. Well, those 5 State income tax returns that they were doing, or we were gonna prepare for turned into 38 state tax returns. So the cost from an administrative standpoint of just having to deal with making sure that you are current on your state filings just because you've got an employee that was in Colorado, but now is in a different location that can actually surprise a lot of companies along the way. So it's really important, Erika, that HR from a payroll perspective reach out, I would say, at least once a year. You can do it probably twice a year. If you've got a very mobile and young type of employee base, you could reach out to them on a quarterly basis and just have the employees verify their current primary address because you'll be surprised to how quickly people move around, or if they want to go, live up in the mountains or out on the east or west coast, how quickly that happens, and how mobile people are, so I always tell companies that they, the Hr function payroll function absolutely needs to have recurring reach outs to the employee base to make sure we understand where the employees are currently sitting.

**Erika Whitmore:**

Yes, and another thing right that they need to be thinking about is the length of time. Right? So we were talking about, hey? You know, like you said, especially during the pandemic. But even somewhat after, you know, I wanna go work in Tuscany.

**Jeff Worlton:**

Sounds awesome.

**Erika Whitmore:**

Right. Let's say a couple of months or a few weeks. How does a company think about that?

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**Jeff Worlton:**

Yeah, it's, you know, typically when you get yourself in trouble from an employee, not being in the US but working overseas somewhere, that typically comes when you have a longer term type of a employee assignment, so you may take an executive or a director, and ship them off to Dublin for 6 months or 8 months, or whatever the case may be. That's when you typically need to think about tax impacts. Not only for the employee. That's a US employee that they may need to actually file tax returns in the foreign jurisdiction on top of the United States. That timeframe typically you need to be overseas for a pretty lengthy period of time. I wanna say it's at least 180 days is probably 180 days to 183 days, I believe, is kind of the tripping point when it comes to those long term assignments overseas. Well, you have to think about that. But I've had a lot of companies that want to send executives overseas to really, you know, kind of kick start a particular operation in Europe, or a particular area of the business that they wanna try to try to get going, and they'll send executives over there, and it may be for a 3 month period time, that 3 month period of time rolls into a 9 month period time. And they don't think about it until after the fact that then you find yourself having the employee really be in a tough position because they should be potentially filing. You know, personal income tax returns in that foreign jurisdiction. You may have to until withhold income taxes on behalf of the employee for that foreign jurisdiction depending on the tax treaties that we've got. It can be just a mess. So it's always prudent to, whenever you actually have someone overseas or thinking about someone doing an overseas type of assignment. That's part of the US. Company, you've gotta bring in a very specialized comp and benefits tax professional that can advise you on what the rules are around a particular jurisdiction. They'll have to look up the tax tree to see if there's any withholding requirements, and so on and so forth. So always try to think about tax when you're making these type of business decisions, I guess, is the point that I'm trying to make.

**Erika Whitmore:**

Yes. So if you have a remote slash, hybrid workforce, put a process. And I like to talk about controls, too. Right? Process controls in place whereby you can figure out where your employees are, so that you're filing the proper tax returns, etc.

**Jeff Worlton:**

Yep, yep. That's super important

**Erika Whitmore:**

The next fun topic that we've had some experience with together is sales and use tax. So maybe, Jeff, if we take a step back, because depending on you know, the audience that can mean a lot of different things to a lot of different people, because it's a fairly complicated topic, right? Maybe you can provide a little bit of an overview before we dive in.

**Jeff Worlton:**

So sales and use tax is, it's commonly referred to as sales and use tax. It's really 2 different types of taxes depending on the kind of the fact pattern that we may be looking at here. It's also referred to as an indirect tax. So it's not associated with an income tax perse. But you know, Erika when you and I go out to the store, we buy some clothes at a brick and mortar store. We're gonna pay sales tax on it. That sales tax if you just think about it from, if you look at your receipt, that sales tax is a one line item amount could be, you know, 5, 6, 7, 8, 9, 10% of whatever the total purchase price was of a product. Within that, you know, 5 to 10% line item that you're getting charged for and that you're paying when you actually get those products. It's made up of State sales tax. It's made up of a city sales tax. It's made up of likely a

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county sales tax as well. Typically sales tax is applied against goods and products. And sometimes it's applied against services. Now, the rule of thumb, at least historically, was that not very many services got caught up in this. Accounting services did, working with attorneys that often got caught up in it as well, but sometimes you found some exceptions along the way where you actually wouldn't have to charge sales tax for the services that are being provided. But States and local jurisdictions are under a constant pressure to bring more revenue into the government coffers, to be able to handle whatever they wanna do with their budgets and sales tax perspective is a very easy tax they can apply across the State to actually have a good revenue raiser form. So they are, actually each state, each city, and each county is going to define what and how they tax goods and services differently. Right? So Colorado is one of the worst ones. They have a ton of different jurisdictions, that all define what services are gonna be taxed differently from each other. Now just take it out to the rest of the Union, and you've got 50 States that you're on top of that. Then you got all the cities, and you got all the counties. I saw a crazy stat. This includes sales and use tax if you will, in it. But the volume of tax levies at the State and local standpoint. If you think about the entire United States, there are over I think it's 48,000 different tax levies that are put on the citizens of the States or the companies of the States as well. So it's just crazy. And you've got each jurisdiction kind of looking out for its own right? So they need to raise revenue. And so they're gonna find certain things a different way than another one,just to try to get a bigger bite of the apple if you will. So it is not gonna get any easier. They're gonna continue to want to expand on what's gonna be taxable. And you know, some of these things will go to go to court kind of like we did from a handful of years ago, from the Wayfair case that talked about taxing goods and services over the Internet, and how that kind of opened up this, big jurisdiction for States to start tapping into, to generate some revenue. Nonetheless, the difference between sales tax and use tax is, kind of interesting. States still want to get as much revenue as they possibly can. So from a use tax perspective, this is when you buy goods and service, or yourself goods and services in a particular state where you don't, the company does not have a physical presence in that state, but they're registered to conduct business in that state. Typically when you sell goods and services primarily goods, there's gonna be a use tax that the seller is gonna be legally obligated to collect and remit to that state as well. So I don't know why they call it use tax just because the company is not, doesn't have a physical presence within that state, but it's really a sales tax. Whether it's the state that you are physically located in from a business standpoint or not. Each State wants to get their bite of the apple when it comes to that. So, Erika, it's crazy because a lot of companies that I've worked with in that high growth type of environment will do a very high level look at whether they think sales and use tax would apply to them, based off of what they do as a business, whether they sell a product or a good, or whether they sell software as a service or whatever the case may be. And it's kind of a cursory look, but it's not bad. And they go no, we're not gonna be subject to sales and use tax right now. We don't believe so, and they may write a memo and put it in their accounting file. What we found is when we go and actually ask a little bit more detailed questions about the type of services that are being sold or the products that are being sold and how they're being sold. Companies haven't gone deep enough in their analysis to determine if the sales and use tax is actually going to apply to them. And this catches almost everyone off guard, and we've had clients where the eyebrows go up and the eyes get really big and they go. Oh, my gosh! We've got a major exposure issue here. And this is to your point earlier on is, you need to have a sales and use tax professional that really focuses a lot of their career in this particular jurisdiction or area of tax to help advise and guide you on. And it's very, prudent for a company, even though maybe their legal team or their sales team doesn't believe that they're gonna trip anything from a sales and use tax perspective. It's very prudent for them to find a local sales and use tax person, or at least a network within that sales and use tax professional has to go and evaluate if their conclusions are reasonable or not. When we're talking about skeletons, especially before a company is wanting to go public. This is one of the ones that not very many companies focus on, and this one's got some teeth, cause that if you, if you've been doing business in a particular jurisdiction for a handful of years, and then you've all of a sudden figured out that you may be on the hook for sales, tax or use tax. It's not only for the current year, but it could be for all those back years that dollar amount can get really, really big, really, really fast. So I'll bring in someone with a special niche focus in that particular area is really really critical. It's worth the money to spend now. So you don't have this skeleton pop up when you're about ready to file an S1 or an S4 down the road and have to account for an exposure you didn't realize that you had.

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**Erika Whitmore:**

Yeah, I mean to your point getting the right individuals in house, and at least from yours and my experience. And we'll give a shout out to Steve Metz from Colorado here, who is who has helped a lot of our clients our joint clients get through some of this stuff. But I think you know to your earlier point just the tax itself the penalties and interest, the amount of you know, manpower that it's gonna take to figure out depending on how complicated and how many locations need to be considered. And then, you know, just even thinking about if it is something that is going to be something you have to track and pay or not. Build your customers, for you know, having some software that will help you comply right can be super helpful and super important.

**Jeff Worlton:**

That's right, because you've got to have software that's going to be able to help you file and manage and manipulate a ton of data. It's really interesting. When you think of a tax department, the tax department, any particular company is most often times the single largest user of data in the entire company. Yeah, cause you gotta you gotta think about it from a from a federal and a state perspective. But then you've got all these other types of taxes that are out there that are overwhelming. Right? You've got capital gains tax. You've got sales tax, use tax, property tax, transportation taxes, franchise taxes, excise taxes, and the list goes on and on and on. And companies are legally obligated to stay current with that. So how can you do that unless you've got help where you've got a really good software system or software systems to help you track this. So being able to identify revenue by geography sometimes down to the local level, is really important with this kind of stuff. And and if you don't, if you, your current systems are not allowing you to track that. You probably again need to pull in someone like a Steve Metz or someone on the sales and use tax side to help guide you on different ways that you can adjust how you're how you can start accounting for that type of data. Because you're gonna need to be able to get your tax filings correct in that regard. You, you know. One thing I forgot to mention Erika was, let's say you find yourself going down this road, and all of a sudden you've got an exposure that you never really anticipated was gonna happen. Certain States, during certain times of year will have a voluntary disclosure type of program where you can approach a State on a no name basis and settle up a potential sales and use tax obligation. And you can talk to the agents there over time. You'll actually let them know what company is involved in this particular type of situation, but they'll let you, and they'll negotiate with you to kind of clear out some of those statched limitation years that never seem to expire, because you've never filed a return into jurisdiction you should have since day one and they'll negotiate that and help you through that process. That process is not a quick process. It tends to take anywhere from 3 to 9 months. Yeah, to actually get that done. But that 3 to but 9 month timeframe Erika only after you've kind of figured out what your exposure is. In the first place, sometimes that takes months to figure out as well. So the timeframe here, if anyone has, you know their sights on potentially doing a public offering at some point. Get the skeleton address early as you can, because this one has a long tail in terms of just a long timeline to be able to wrap things up.

**Erika Whitmore:**

Yup. And and this was one thing I was gonna make sure that I mentioned our previous, podcast on IPO readiness. And and just making sure you're thinking through the right things, right to prepare yourself for really any kind of transaction. This would be key, right? It's making sure that you've got your, you know "Tax House" in order. It just can add to the timeline if there's things there that need to be worked out, so to speak.

**Jeff Worlton:**

Yeah, there's no doubt about that. No doubt about that.

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**Erika Whitmore:**

So we've just got a few minutes left for our last topic. But let's talk a little bit about equity compensation and kind of what you see companies trip up on in terms of equity awards.

**Jeff Worlton:**

Yeah, so this is a great topic as well. So typically the HR group who handles payroll will be involved with equity compensation. And one of the things that I consistently see in the high growth in the emerging market type of companies is just making sure that number one when a plan is being developed or being modified. HR and Payroll need to be intimately familiar with that because typically the tax department doesn't necessarily get involved when it comes to equity compensation. Now for those companies that actually do have the tax department involved with them. Same goes. Is that anytime you have a modification to an existing comp plan, or you're developing a new one for let's call up for a new tranche of awards that are gonna be coming out. The tax department payroll HR group needs to be involved so they understand what the impact is gonna be to the company as well as to the employees. That's number one where I see a common mistake is that you're not connecting the dots and making sure that everyone has a seat at the table to understand what the change is gonna be on the company. The second area within equity comp that I see missed. And it really, it's kind of surprising that this happens. But it just happens, is more of an educational type of issue, and it really relates to restricted stock awards. Restricted stock is just that it's a very restrictive type of stock that is granted to certain types of employees, typically executives, and directors. And it has some pretty severe, well not severe, but maybe strict type of rules around it in terms of how long you have to hold it before you can sell it. So on and so forth. It's really done to incentivize, a lot of employees to work hard and try to get the best results out of the company as you possibly can. Right? So restrictive stock. There is a code section called 83 B. 83 B is this cool little thing within the tax code that allows whoever is the recipient of a restricted stock award to elect to include the fair value of that award at the time of Grant into their personal income tax return for that particular year and pay taxes upfront. It's kind of a prepayment of taxes. And then what happens down the road is let's say you have to hold on to this restricted stock for 2 or 3 years. And then you sell it. Any appreciation that actually is found within that restricted stock. So when this, let's say you invest and the stock is $10 higher a share than what it was when it when it was granted. You only pay capital gains tax on that difference in appreciation. And so capital gains tax, as everyone knows, has a much lower tax bite than the ordinary or marg your highest marginal tax rate from an individual income tax perspective. The issue that I that often is that when restricted stock is awarded, HR Either does or does not hand a package, an informational package to the recipient, and it sometimes covers an 83 B election option for the recipient, or sometimes it just doesn't. And the one thing that gets missed often is that the recipient has 30 days to make the election to actually do an 83 B. So they have 30 days after that award is actually granted.

**Erika Whitmore:**

That's important.

**Jeff Worlton:**

Yeah, yeah that's right. So they have 30 days after that award is actually granted to make that election. If they miss that window they can't pay those, prepay, those taxes upfront, and so, whatever price point fair value. They actually sell that restricted stock 2 years down the road. The entire amount gets that's put into your personal tax return at your highest marginal tax rate. So you're missing out on saving a lot of taxes as a result of not making that election. It it's kind of mind boggling, that the election gets missed by people, and it's really at the at the individual level. Just people forget or they just aren't aware and don't flip through this package. But when HR or whoever is actually educating the recipient about the restricted stock, they have to make it kind of big, bold letters, highlighted 83 election. You've got 30 days where you have to apply by this one, or you miss out on this tax planning strategy at the personal level. So I see a lot of that actually being best, just needs better communication from the company to the individual employees.

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**Erika Whitmore:**

Yup, and just a clarification on that. And tell me if I'm right on this, Jeff, that's primarily related to kind of what I would call like plain vanilla restricted stock. Meaning, it's granted, and it best over a period of time as long as the employee is employed. Not necessarily a performance based award or something that has you know it's a little more complicated. Is that fair to say?

**Jeff Worlton:**

That is absolutely right on the mark, that's right. That's exactly it.

**Erika Whitmore:**

Those awards are a topic for a different day.

**Jeff Worlton:**

Yeah, that sounds good.

**Erika Whitmore:**

Well, you know what, Jeff, that kind of brings us to the end here. Maybe just real quick before we go. What are some parting thoughts for our audience, just to you know anything else to make sure that they're at least thinking about or ask for help on before we wrap up today.

**Jeff Worlton:**

Yeah, ya know, that's a really good comment here, Erika is, find yourself a good tax accountant one that has a very, broad, base network to handle a lot of different topics, whether that's, you know, sales and use tax or equity compensation. Or, you know foreign operations if the company is expanding outside the United States, or if they're sending employees out overseas to do a certain job that is longer than 6 months. And so it's really important just to have someone that can help guide you along the way. And one of the things I always try to do certainly for my earlier start up high growth companies is, make sure that you have your tax person whether it's in house or is it external service provider. Make sure you include them in on any operational changes that may that may be coming down the pipe from the company, because anything that is done from an operational perspective will have a tax ramification to it. So we need to think about that, just to make sure that we've got you covered.

**Erika Whitmore:**

And just a follow on that any transaction as well. Right? I mean, I think you know we're moving fast, and things are happening fast, especially in the in the deal world, even though that's maybe quiet today. There's understanding the tax implications are just super important. So getting the tax folks involved early and often is very important. It's a big deal. No one likes surprises and tax always seems to be the surprise topic, that topic that no one at wants to talk about and it's always a surprise. You mean, I have to pay what in tax? So it's always good to bring in the folks early, and often.

Yup, exactly. Well, Jeff, thank you so much for your time today. I really appreciate you joining me and I hope you'll be willing to join me again on a future podcast.

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**Jeff Worlton:**

Thanks, Erika. I would love to. Had a great time, appreciate it.

**Erika Whitmore:**

Awesome, Thank You.

**Jeff Worlton:**

You bet, Thank you.

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