

Understanding and Managing Sales/Use Tax in a Complex Environment

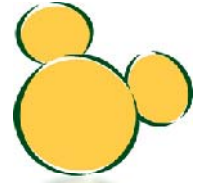
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Basic Concepts



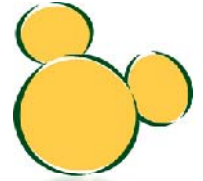
- ❑ Today, 45 states + DC impose some type of sales/use tax.
- ❑ Most state laws enable localities to impose sales/use tax.
- ❑ Locals *generally* follow state laws, but not always.
- ❑ Today, over 6,700 different jurisdictions impose sales/use tax. Rates change regularly.

Sales vs Use Tax



- ❑ Sales tax – imposed on intrastate sales, local rate calculation depends on state’s situs rules.
- ❑ Use tax – imposed on interstate sales, if local tax applies it is based on destination.
 - ❑ If supplier has nexus* in destination jurisdiction, they should collect the use tax (seller’s use tax)
 - ❑ If supplier does not have nexus, buyer accrues the tax themselves (consumer’s use tax)
 - ❑ **Quill Corporation v North Dakota, 112 S.Ct. 1904 (1992). Supreme Court determined Commerce Clause requires substantial nexus, which requires physical presence to establish sales/use tax collection responsibility.*

Illinois Examples – Sales Tax



Interstate:

- Sales Tax
- 6.25%

Local Tax:

- Origin



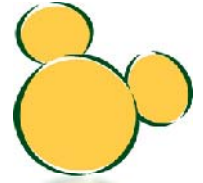
Local Rate: 4%

Total: 10.25%

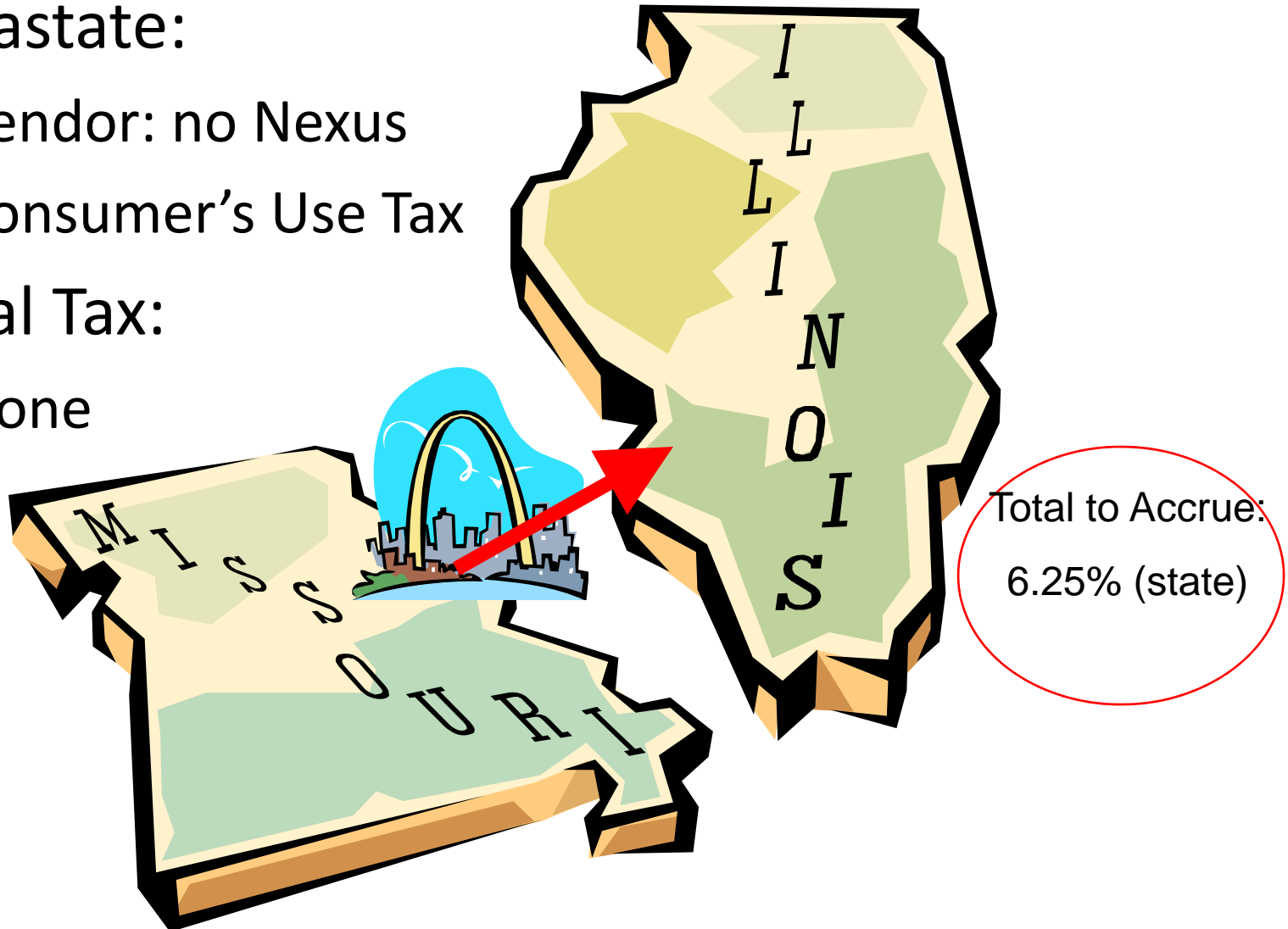
Local Rate:
1.35%

Total: 7.6%

Illinois Example – Use Tax



- Intrastate:
 - Vendor: no Nexus
 - Consumer's Use Tax
- Local Tax:
 - None



Taxability



- Real Property
- Tangible Personal Property
- Services
 - I.e. Fabrication vs Installation vs Repair
- Mixed Transactions
 - i.e. Furnish + Install, Repair + TPP
- “Other”
 - Telecommunications
 - Downloads
 - Admissions

Exemptions, Exclusions



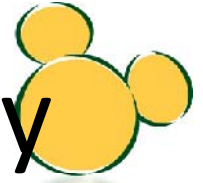
- ❑ Nature of the Parties
 - ❑ Government, Religious, Charitable
- ❑ Nature of the Product or Service
 - ❑ Groceries, Medicines, Professional Svc
- ❑ Nature of the Use or other Disposition of the Product
 - ❑ Production, Post-Production, Broadcasting, Electronic Delivery, Resale
- ❑ Other
 - ❑ Occasional/Isolated Sales, Holidays

Impact to Disney



- ❑ Disney operates in over 40 countries with over 700 legal entities
- ❑ In 2001, consolidate over 400 back-office systems to one single instance of SAP
- ❑ Created series of common business processes and developed shared services model
- ❑ Centralized Sales/Use Tax Group
 - ❑ Over 400 sales/use tax reconciliations/tax filings monthly

Sales/Use Tax Collected at Disney



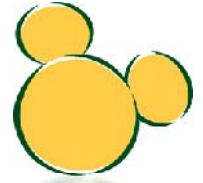
- ❑ Depends on Segment
 - ❑ Studio/Media
 - ❑ Theatrical Release, Home Entertainment, Broadcasting, Licensing, etc.
 - ❑ Theme Parks & Resorts
 - ❑ Admissions, Resorts, Food & Beverage – depends on state
 - ❑ Consumer Products
- ❑ Over \$1.5b sales tax collections per year

Sales/Use Taxes Paid at Disney



- ❑ Over \$16b in spend annually
- ❑ Over \$300m in s/u taxes paid to vendors annually
- ❑ Over \$65m in consumers use tax accruals annually
- ❑ Taxability is very fact driven. Dependent on facts of each purchase.
- ❑ Who, What, Where, Delivery Method, How Used

Need for Tax Automation



- ❑ Disney represents multiple industries within multiple states, taxability rules vary greatly
- ❑ Decentralized Purchasing with over 20k Casual Buyers
- ❑ Centralized Accounts Payable processing over 1 million purchase orders per year
- ❑ Electronic Invoicing Solutions

Basic Design



- ❑ Purchase Orders created by Buyer in SAP
- ❑ Buyer provides necessary data to automatically determine tax calculation
 - ❑ Who, What, Where, How Used
- ❑ Data is passed from SAP to separate tax calculation package
- ❑ Tax calculation is determined and passed back to Purchase Order
- ❑ Invoices are processed by Accounts Payable (with exception of electronic invoicing)
- ❑ AP compares tax from vendor (or lack of tax) against PO calculation, performs 'matching rules'.

Challenges



- ❑ Sales/Use tax rules vary greatly among states. Even with the best automated design, many rules present challenges.
 - ❑ Repair Labor, Fabrication + Installation, Electronic Delivery location, Donuts with fork/plate or without
- ❑ Maintaining/retrieving proper supporting documentation (form over substance)
- ❑ Current economic conditions increase tax and audit risk/exposure.
 - ❑ Increasing tax base, rates.
 - ❑ Increased audits.
 - ❑ Affiliated nexus.

Conclusion



- For many companies, sales/use taxes costs are harder to visualize than that of corporate income taxes.
- On average, sales/use tax collections represent over 1/3 of state revenues.
- Risk of non-compliance under audit can be huge.
- As states and other jurisdictions become increasingly aggressive about collecting taxes, companies are dealing with sales/use tax audits at an alarming rate.
- Many opportunities to reduce risk and costs with proper sales/use tax planning.