

What Will Become of the Nevada Commerce Tax?

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The bumpy road to broadening Nevada's tax base may be getting bumpier.

After Nevada voters soundly rejected a margins tax initiative on the November 2014 ballot, Governor Brian Sandoval's administration successfully pushed its own tax package through the 2015 Nevada Legislature. The package included a tax on gross revenue: the Nevada Commerce Tax. (NCT).¹

Last August, a coalition (led by State Controller Ron Knecht) filed a referendum petition to put the issue back in front of voters. In December 2015, a Nevada court ruled the referendum can go forward, a ruling now on appeal to the Nevada Supreme Court. If the referendum does qualify for the ballot, voters will be asked to disapprove or approve the NCT in November. If approved, the NCT would become a “referred law,” precluding the legislature from addressing problematic provisions absent another vote of the people.² If disapproved, the NCT would be repealed.

The first year’s commerce tax payment is due in mid-August (with one 30-day extension). This creates an odd situation: legal claims may arise in August, but some taxpayers might prefer to wait to see what happens in November; this could also provide a very short window for a legislative amendment to fend off a legal challenge. This article explores some of the possible legal bases for such challenges.

What is the NCT?

The NCT is a tax on the “privilege of engaging in a business in this state,” modeled on similar taxes in Ohio, Texas and Washington. The NCT taxes a business’ total sales of goods and services, with no deduction for the cost of goods sold or other expenses. Permitted exclusions include receipts from the sale or lease of intellectual property, customer cash discounts and gifts, certain

capital contributions and distributions, and charitable contributions.

Gross receipts are situated (or sourced) to Nevada where a purchased item is delivered into Nevada, or in proportion to the benefit a purchaser derives from services in Nevada. Nevada businesses can take certain exclusions for other gross receipts-type taxes (gaming, mining and insurance), and are entitled to a partial credit against the Nevada modified business tax.

There is a \$4 million gross revenue threshold before a tax is due, but even a business with no taxable gross revenue must file a return. The NCT specifies 26 different business classifications pulled from the North American Industry Classification System (NAICS), with corresponding tax rates ranging from .051 to .331 percent (with a catchall or default rate of .128 percent). Revenue collected under the NCT is deposited in the general fund.

Finally, the NCT states that it does not apply to a business entity or gross revenue that Nevada is prohibited from taxing under the Nevada or federal constitutions.

Possible Legal Challenges Under the Nevada Constitution

Nevada Uniform and Equal Taxation Clause

Nevada’s uniform and equal clause requires a “uniform and equal rate of assessment and taxation.”³ The Texas margins tax was challenged under a similar constitutional provision in 2002. There, the Texas Supreme Court upheld the classifications on grounds they were rationally designed to “assist in achieving tax equality and uniformity.” Here, such a finding could be more difficult. In contrast to Texas’ three categories (wholesalers, retailers and all other), the NCT has 26 classifications pulled from more than 19,000 NAICS codes (that cover “everything from abattoirs

(slaughterhouses) to zucchini farming”).⁴ And, in contrast to Texas’ two tax rates, the highest of the NCT’s 26 rates are six times that of the lowest rates.⁵

Nevada Tax Exemptions

The Nevada constitution exempts certain types of property or transactions from taxation, including “business inventories,”⁶ “[s]hares of stock, bonds, mortgages, notes, bank deposits, book accounts and credits, and securities and choses in action of like character,”⁷ and “food for human consumption.”⁸ These exemptions might provide a basis for a challenge to the NCT, to the extent that such revenues are not excluded for purposes of the NCT.

Nevada Spending Limitations

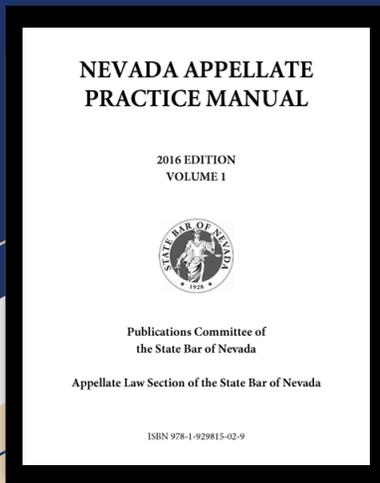
Under the Nevada constitution “proceeds from the imposition of any excise tax on gasoline or other motor vehicle fuel” are earmarked for the “construction, maintenance, and repair of the public highways.”⁹ The NCT, however, does not exclude such revenues. The Ohio Supreme Court found that state’s gross receipts tax to be unconstitutional as applied to receipts from the sale of motor vehicle fuel, but ruled the state could still collect the tax, as long as the revenue was only expended for public highways. A challenge to the NCT might result in a similar outcome. Namely, the tax on motor vehicle-fuel sales receipts could be found unconstitutional, but still be collectable as long as such revenues are not deposited in the general fund, but instead appropriately segregated and earmarked.

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What Will Become of the Nevada Commerce Tax?

U.S. Constitution

Commerce Clause

Under the Commerce Clause of the U.S. Constitution, a state may only tax a fairly apportioned share of gross receipts generated by an interstate business activity. In order to reach an out-of-state entity, the tax must be: applied to an activity with a substantial nexus with the taxing state, fairly apportioned and nondiscriminatory with respect to interstate commerce, and fairly related to the services provided by the state. The NCT's reporting and taxing requirements, however, are not tied to any specific nexus requirement – for example, a business's physical presence or any other threshold of in-state business activity in Nevada (*i.e.* economic nexus). On this basis, the NCT might be vulnerable to challenge by an out-of-state business that sells into Nevada but has no physical presence or other activity significantly associated with its ability to establish and maintain a market for its products. Aspects of the NCT might also be vulnerable on grounds they are unconstitutionally discriminatory to the extent that certain in-state deductions or exemptions are not available to out-of-state businesses. For example, the NCT allows Nevada businesses that already pay a gross receipts-type tax (gaming, mining and insurance) to exclude from their NCT gross revenue the amount of gross revenue subject to those other Nevada taxes.

Federal Preemption

Under the Supremacy Clause, federal statutes constitute the supreme law of the land. At least two aspects of the NCT are vulnerable to a challenge on this basis. First, with respect to rail transportation, the NCT applies the highest tax rate of .331 percent. The federal Railroad Revitalization and Regulatory Reform (4-R) Act (49 U.S.C. § 11501(b)(4)) prohibits states from taxing railroads more than it does comparable industries. However, the NCT does not apply a uniform rate to all transportation companies: truck transportation is taxed at .202 percent, and all "other transportation" at .129 percent. Second, the NCT purports to tax air transportation at a rate of .058 percent. However, state taxation of gross receipts of air transportation is also preempted by federal law (49 U.S.C. 40116(b)).

Looking Ahead

Some of the foregoing legal challenges may ripen with the first year's NCT payment due in mid-August. Given the chance the referendum does qualify for the ballot, potential challenges might be forestalled until after

the results in November. However, if approved, the NCT will be protected from legislative amendment absent another vote of the people. In that case, the legislature would have to move very quickly to avoid future legal challenges to the NCT. And, the bumpy road to broadening Nevada's tax base could get even bumpier. **NL**

1. Senate Bill (SB) 483 (2015) (SB 483).
2. Nev. Const. art. 19, § 1.
3. Nev. Const. art. 10, § 1 (1).
4. Joseph Henchman, Liz Malm, Jared Walczak, THE 13 MILLION PERCENT TAX: NEVADA CONSIDERS COMPLEX, ARBITRARY BLF PROPOSAL (March 25, 2015). The Nevada classifications appear to be based on a 2011 Texas study used to estimate that state's impact on certain selected sectors. Senate Committee of the Whole (March 23, 2015), NTA Question & Responses.
5. The justification for some distinctions is not readily clear: "air transportation" is taxed at .058 percent, while "other transportation" (including "scenic and sightseeing air transportation") is taxed at 0.129 percent, and "rail" is taxed at 0.331, "truck" at 0.202, and all "other" at .129 percent.
6. Nev. Const. art. 10, § 1 (6).
7. Nev. Const. art. 10, § 1 (2). The NCT does contemplate that some intangible assets or revenues derived therefrom are not taxable gross revenues. However, a challenge might nevertheless be brought to the extent the NCT does tax gross revenue derived from exempt intangible assets.
8. Nev. Const. art. 10, § 3[A]. Recently, the Ohio commercial activity tax was challenged on a similar state constitutional provision, wherein the court found that while the constitution would prohibit a tax imposed on each "sale" of food, it did not bar the "consideration of receipts from food sales in measuring the value of the privilege of doing business."
9. Nev. Const. art. 9, § 5.

PAUL D. BANCROFT focuses his practice on state and local taxation, including property tax, sales and use tax, net proceeds of mines tax and real property transfer tax. He provides advice and representation to clients on the application of taxes imposed by Nevada and its local governments and on the tax treatment of proposed developments and transactions. He assists clients in shaping Nevada's tax laws through legislation and the regulatory rulemaking process that implements legislation. Bancroft has been designated by the American Property Tax Counsel as the professional representative for the state of Nevada.



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