# *Wayfair* and Beyond

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# *Good morning!*

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## *Topics*

I. Sales and Use Tax Overview

II. *Wayfair* Overview

III. Impact of Wayfair

# *Sales and use tax overview*

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## What is sales tax?

A sales tax is generally a tax applied to the retail sale of **tangible personal property and certain services**. Currently, 45 states and the District of Columbia impose a sales tax. Oregon, Delaware, Alaska, Montana, and New Hampshire do not impose a retail sales tax.

Sales tax is a major revenue source for the states, as well as for local jurisdictions that 'piggy back' the state tax.

- **State rate**: usually 4 - 7%. **Local rate**: usually 0.125 - 5%.
- Sales tax is a tax on consumption, but it is not a 'consumption tax.' It is more accurately labeled a 'transaction tax.'
- **Use tax** complements the sales tax where title passes outside the taxing state. Most audit activities today involve the use tax.

# *Sales and use tax overview*

## What exemptions exist?

Exemptions are allowed by all taxing states for certain property, transactions, purchasers, and sellers. These transactions are normally subject to tax, but because certain conditions are met, they are exempt from sales and use tax.

Sales and use tax exemptions can be categorized broadly into three groups:

1. **Status exemptions** -- e.g., governmental entities, charitable organizations, and not-for-profits.
2. **Object exemptions** -- e.g., certain food, medicines, and clothing.
3. **Utilization exemptions** -- e.g., resale exemptions and machinery and equipment exemptions.

# *Sales and use tax overview*

## What is sales and use tax *nexus*?

- Allows a state to exercise its taxing authority over a company.
- Pre-*Wayfair* federal law required some sort of **physical presence** in the state to establish nexus for sales and use tax purposes.
- Several states were already attempting to expand nexus beyond the physical presence requirement, e.g. click-through nexus, affiliate nexus, and economic nexus.

# ***Wayfair* Decision**

From *Bellas Hess* to *Quill* to *Wayfair*

# *Quill – Bright-line rule requiring physical presence*

## *Quill Corporation v. North Dakota, 504 U.S. 298 (1992)*

- *Quill Corporation v. North Dakota* involved whether Quill Corporation, a mail order office supply retailer, was required to collect sales tax on sales made to North Dakota customers by telephone and catalog.
- Quill Corporation had no physical presence in North Dakota, but solicited business from North Dakota customers by telephone and mail order, and delivered merchandise by common carriers.
- The United States Supreme Court upheld the physical presence requirement confirmed in another sales tax case, *National Bellas Hess v. Illinois Department of Revenue,* 386 U.S. 753 (1967). The Court ruled that a taxpayer must have a physical presence in a state in order to require sales tax for purchases made by in-state customers. The existence of customers alone did not create sufficient nexus under the Commerce Clause.
- The Court clarified the distinctions between the Due Process Clause and the Commerce Clause, and concluded that the vendor had sufficient "minimum contacts" under the Due Process Clause, but did not have "substantial nexus" under the Commerce Clause.

## *State nexus expansion*

- Affiliate nexus
- Click-through nexus
- Marketplace provider collection
- In-state software and content distribution network (e.g., cookie nexus)
- Use tax notice and reporting
- Economic nexus

# *South Dakota v. Wayfair*

## South Dakota S.B. 106

- On March 22, 2016, South Dakota enacted S.B. 106, which requires sales tax collection and remittance for any entity exceeding an annual sales threshold of $100,000 or 200 separate transactions in South Dakota. S.B. 106 also provided an expedited appeals process to challenge *Quill*.
- Following enactment of S.B. 106, South Dakota filed a declaratory judgement action against remote sellers with no physical presence in the state. South Dakota sought a determination that it may require the remote sellers to collect and remit sales tax.
- On September 13, 2017, the South Dakota Supreme Court held that the state's economic nexus provisions were unconstitutional. *Quill* remained the controlling precedent on the issue of Commerce Clause limitations on interstate collection of sales and use taxes.

# *South Dakota v. Wayfair*

## Appeal to US Supreme Court

- Following the South Dakota Supreme Court's ruling, the State appealed the decision to the United States Supreme Court.
- On January 12, 2018, the US Supreme Court granted certiorari and agreed to hear the case.
- Oral arguments were held on April 17, 2018.

## ***South Dakota v. Wayfair***

- The *Wayfair* decision, giving states the freedom to reach beyond their borders to compel sellers to collect and remit tax, is the *most groundbreaking event* in US state taxation in decades.
- Court ruled, by 5 to 4, in favor of South Dakota
- *Quill* physical presence standard overturned - "unsound and incorrect"
- Both *Quill* and *National Bellas Hess* were overruled
- The "substantial nexus" requirement articulated in *Complete Auto*—can be met with a "substantial virtual connection"
- Majority opinion refers to *Quill* as a "judicially created tax shelter"
- All 9 justices agreed that *Quill* was wrong, but disagreed over the proper solution

# *South Dakota v. Wayfair*

## Key Aspects of Dissent

• The dissent noted that “Bellas Hess was wrongly decided for many of the reasons given by the Court [in the majority opinion]”

•Favors a Congressional/national solution to securing new tax revenues

•If stare decisis was important in Quill, it should have been even more critical in Wayfair

•Correctly calculating tax on all e-commerce sales will likely prove baffling for many retailers—including 10,000 jurisdictions that have varying rules and “different standards for determining whether an out of state seller has a substantial presence in the jurisdiction”

•Nothing in the decision precludes Congress from continuing to seek a legislative solution

## *State Reactions to Wayfair*

The Court commented on 3 aspects of SD law that tended to reduce burdens

| **The Decision** | **State Responses** |
|---|---|
| No retroactive application | Enforcement dates are prospective* 10/1/18, 11/1/18 and 1/1/19 |
| Adoption of Thresholds | Similar thresholds adopted by most states* ($100,000 or 200 Transactions) |
| Member of SSUTA<br>Including free software | HMMMMMM |

# *Substantial nexus without physical presence*

- South Dakota statute
- State updates – economic thresholds and effective dates
- Retroactivity concerns
- State simplification efforts
- Marketplace providers
- Notice and Reporting laws
- Sourcing madness
- Federal legislation
- State income tax nexus

# ***South Dakota's Economic Nexus Statute Provisions***

- A seller will have a sales tax collection obligation "provided the seller meets *either* of the following criteria in the previous calendar year or the current calendar year:

  (1) The seller's gross revenue from the sale of tangible personal property, any product transferred electronically, or services delivered into South Dakota exceeds **one hundred thousand dollars**; or

  (2) The seller sold tangible personal property, any product transferred electronically, or services for delivery into South Dakota in **two hundred or more separate transactions**."

- Other important provisions:
  - S.B. 106 states "no obligation to remit the sales tax required by this Act may be applied **retroactively**. "
  - Simplification and administrative ease:
    - South Dakota has only **one tax rate**, unlike other states with numerous varying local sales tax rates. This makes the administrative burden of collecting the sales tax significantly easier.
    - South Dakota is a member of the Streamlined Sales and Use Tax Agreement, which provides sellers access to **tax software** paid for by the state, which provides them with **audit liability immunity**.

# *Possible State Actions*

- Approximately 15 states (with a sales tax) have yet to issue formal *Wayfair* guidance
  - The largest four states (CA, TX, FL, and NY) have yet to issue formal guidance
  - Almost all of the states have adopted economic thresholds equal to or higher than South Dakota's
    - The exceptions are WA, PA, and OK, which have $10,000 thresholds, but may allow a Notice and Reporting option in lieu of requiring sales tax registration
  - Many states, however, have not implemented any tax simplification reforms (e.g., single rate)
  - There are 5 states with no sales tax (New Hampshire, Oregon, Montana, Alaska, Delaware (NOMAD))
- Anticipated enforcement actions
- Threshold for local jurisdictions
  - Does each jurisdiction need to meet the threshold? (See dissenting opinion)
- More litigation
  - Other states thresholds or tax systems
  - Small business

## *Federal Legislation*

- 4 bills have been introduced in 115th Congress
  - HR 6824 Online Sales Simplicity and Small Business Relief Act
  - HR 6724 Protecting Businesses from Burdensome Compliance Cost Act of 2018
  - HR 2887  No Regulation without Representation Act.
  - S 3180—Stop Taxing Our Potential (NOMAD states)

# *Federal Legislation*

- Reinstate the physical presence standard?
- Require simplification?
- H.B. 6824 dubbed **Online Sales Simplicity and Small Business Relief Act of 2018**
  - Sellers with annual gross receipts of less than $10 million in the United States would be considered small sellers.
  - Such sellers would be exempt from collecting taxes until "the States develop and Congress approves an interstate compact, applicable to the State and sale, governing the imposition of tax collection duties on remote sellers," the bill says.
  - H.B. 6824 has been referred to the House Judiciary Committee, which held a hearing in July on the *Wayfair* decision.

# Impact of *Wayfair*

# *Impacted Businesses*

- Small Businesses
- Technology providers
- Digital product providers
- Service businesses
- In-bound retailers
- Tax software providers
- Certified service providers
- Marketplace facilitators
- Basically all businesses in some way

# *Impact on sellers*

## Registration and Collection Requirement in New Jurisdictions

## Some of the Challenges

On each transaction, you must determine the following:

1. Where is the taxing jurisdiction? (*is your customer/vendor/location data complete enough to make that determination?*)
2. Which of the 5,000 different sales rate combinations is applicable in the taxing jurisdiction? (*which have the possibility to change every 15 days*)
3. Do you need to calculate sales tax in that taxing jurisdiction?
4. What is your product's unique tax treatment in the taxing jurisdiction? (*which may change between taxing jurisdiction and over time*)
5. Is an customer exemption applicable to the sale (*e.g., government purchases*)?
   - If so, do you have the right information on file?
   - If so, has it expired?
6. Is your sale to an end consumer?
   - If not, do you have the appropriate exemption information on file?
   - If so, has it expired?

## How do business account for these challenges?

- ➢ Through the support of 3rd party web-services ('tax engines')
- ➢ Through configuring their ERP to the appropriate detail and updating it over time (through 3rd rates cards or robotics)

# *Impact on use tax*

- Exemption Routines
  - Expect increased activity in requirements to provide exemption documentation
  - B to B Suppliers charging tax prior to requesting certificates and dealing with short pays
- Modification to existing tax validation routines required
  - Increased number of vendors charging sales tax
  - Over aggressive interpretation of taxability
  - Proper sourcing particularly regarding services, digital products
  - Correct application of rates
  - Accounting for blended rates (AL SSUT) potentially outside of tolerance
- Potential increase to short payments with vendor stuck in the middle having already remitted the tax
- Is tax paid to remote vendor “legally due”

# *Impact on sales tax reserves*

- Q-3 (for calendar year businesses)
  - Recommending a state by state review
  - States with delayed effective dates
  - State guidance on enforcement plans
  - Retroactivity considerations (prior nexus)
  - Probability of liability and materiality
- Future periods

# *Impact on income tax*

Potential ASC 740 Considerations may include:

- New separate company filing obligations
- Combined / unitary filings
  - New filing obligations based on one member having nexus
  - Impact to sales apportionment based on Joyce/Finnigan filing requirement
  - NOL and credit utilization within the group
- P.L. 86-272 is still valid after Wayfair.
  - P.L. 86-272 generally precludes a state from imposing an income tax if the only in-state business activities involve the solicitation of orders for sales of tangible personal property.
  - If virtual connections can create nexus, can virtual connections constitute an "in-state" activity that exceeds solicitation such that the protections of P.L. 86-272 are lost?
  - Note that, by its terms, P.L. 86-272 protection operates in interstate commerce, not foreign commerce.

# *Impact on foreign sellers*

- Nothing in *Wayfair* decision limits holding to domestic US companies
- In *Japan Line Ltd. V. County of Los Angeles*, 441 US 434 (1979), US Supreme Court addressed the Foreign Commerce Clause:
  - Court first applies four part test under the Commerce Clause set out in *Complete Auto* – *Wayfair* said that the "substantial nexus" requirement articulated in *Complete Auto*—can be met with a "substantial virtual connection"
  - Under Foreign Commerce Clause, a tax must not create unconstitutional "international multiple taxation;" and the tax must not prevent the US from speaking with "one voice" in regulating foreign trade.
- Risk of double taxation? The statute here requires the mere *collection* of the tax and not the *imposition* of tax

# *Impacted foreign industries*

- E-commerce and retail sectors
- Marketplace providers/facilitators/platforms
  - Different business models - Amazon marketplace vs. Ebay vs. Craigslist
- Technology companies
  - Traditionally small physical footprint with users everywhere
  - Sellers of software, cloud-computing, data processing, information services, and other digital products and services – digital streaming….video, audio, digital platforms
  - Banks acquiring fintech companies and making taxable sales
- B2B sellers…. sale for resale – register and get resale certificates?
- Multinationals with significant intercompany transactions…sales to US subsidiaries….for resale or end-users (e.g., consuming software to perform business)
  - 'consolidated' intercompany sales tax returns

# *What next? The practical considerations*

**Nexus**

- Given the fluidity and uncertainty around how states will adopt the *Wayfair* ruling, leveraging analytics and visualization tools to perform scenario modelling (i.e., change management)
- Using analytics and visualization tools to gain better insights into tax footprint, which will allow companies to efficiently make strategic business decisions

**Tax Compliance**

- Companies will likely have to file sales and use tax returns in more states
- Additional compliance related activities (e.g., registrations, VDAs, remediation, and reserve management) will put added burden on already stretched tax departments, hence the need to automate compliance and internal processes

**Systems**

- Updates to currently existing tax engine/ERP/billing systems to ensure tax is being assessed accurately in new jurisdictions
- Perform ad-hoc data analyses/visualizations to determine exposure prior to initiating VDAs
- Use of technology to streamline audit defense processes such as data extraction from ERP, reconciliation, invoice batch extraction, etc.

**Other Tax Considerations**

- Did the physical presence standard ever apply in income tax context? (Retroactivity?)
- MTC Factor Presence standard would apply if state has adopted it
- Business community needs recognizable standard for applying nexus analysis

# Questions?

# *Thank you!*