

Wayfair 2.0: States Respond to the Wayfair v. South Dakota Supreme Court Decision

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- A professional services firm with three distinct business lines
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Learning Objectives

- At the end of this session, you will be able to:
 - Review which states have already adopted economic sales tax nexus laws — and the ones that may soon enact them
 - Describe the new laws in select, highly complex states like Colorado
 - Determine how to respond if you have sales tax economic nexus in a state, but lack the capacity to comply
 - Illustrate compliance strategies, including:
 - Analyzing taxability
 - Outsourcing options
 - Registering through the Streamlined Sales and Use Tax Agreement (SSUTA)
 - Managing exemption certificates



Speaker Introductions



Rance Morton, CPA, Manager

Rance is a Manager in CLA's SALT group with more than 10 years of SALT experience focusing on sales and use tax. He is the leader of CLA's Sales Tax Compliance Outsourcing practice and works extensively with sales and use tax compliance, taxability determinations, sales and use tax audits, and various other consulting engagements.



Dan Kidney, CPA, JD, Director

Dan is a Director in CLA's SALT group with more than 18 years of SALT experience. He works extensively with multi-state tax planning, compliance and controversy issues including nexus issues, and leads the CLA SALT group's national tax office.



Getting Up to Speed

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What is *Wayfair*?

- *South Dakota v. Wayfair, Inc. et. al.* (585 U.S. ____) is a 5-4 U.S. Supreme Court decision issued on June 21, 2018.
 - The Court overturned the physical presence requirement for sales tax “substantial nexus”, from *Quill Corp. v. North Dakota* (1992).
- States now have the **possibility** of enforcing a sales tax collection requirement (nexus) over remote sellers.
 - The Court did not rule on the constitutionality of any particular economic nexus law.
 - It sent the case back to SD to address the constitutionality of its law, but the parties settled out of court in October 2018.

Who is a Remote Seller?

- The term “remote seller” is often thought of as a company who sells goods/services over the Internet.
- However, it can apply to any company who makes sales into a state where it does not maintain a physical presence:
 - Online sales
 - Purchase orders
 - Telephone orders
 - Catalog sales
 - Automatic replenishment order systems – supply chain management
- *Wayfair* does not only apply to Internet sellers!

Wayfair – The Court Decision

The Court overturned *Quill*

- It acknowledged that Congress could take action.

The Court did not decide whether South Dakota's law was constitutional

- It sent the case back (remanded it) to the SD court system to decide whether SD's law places an "undue burden" on interstate commerce.
- The "undue burden" test is unknown, though the Court suggested the balancing test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970).

However, the Court suggested that SD's law would be upheld because of three specific aspects of that law (the "blueprint")

Wayfair – the “Blueprint”

- Justice Kennedy spoke favorably about the chances of SD’s law being upheld on remand for three reasons:
 - Its numeric threshold (>\$100k in sales or 200+ transactions) provided small sellers a “reasonable degree of protection.”
 - Its law prohibited retroactive collection.
 - SD is part of the Streamlined Sales and Use Tax Agreement (SSUTA).

Single, state level tax administration	Uniform definitions
Simplified tax rate structures	Access to sales tax administration software “paid for by the State”
Other uniform rules	Audit immunity for sellers who use this free software

- SSUTA has 30% of the U.S. population: not CA, TX, NY, IL, PA, or FL.

Wayfair settled with State of South Dakota

- As of Oct. 31, 2018, the case was settled and the parties to the case (Wayfair, Overstock, and Newegg) began collecting South Dakota sales tax on January 1, 2019 as part of the agreement.
- Due to the settlement, however, the South Dakota court will no longer rule on the constitutionality of South Dakota's specific law and thresholds.
- States have continued to impose economic nexus standards without waiting for formal guidance about whether, and if so why, laws like South Dakota's are constitutional.
- Companies should take these laws seriously and should not use the lack of comprehensive guidance as a justification for inaction.

Is Sales Tax Economic Nexus Here to Stay?

- Federal legislation has been proposed but passage in near term is unlikely.
 - Federal lawmakers have much to lose and little to gain since they would be limiting the authority their states have worked hard to get.
 - 2018 lame duck session was viewed as best opportunity to pass legislation.
 - If the states act irrationally (i.e. retroactivity) then Congress may intervene.
- Issues that may be challenged, such as the threshold requirement and retroactivity, will need to be litigated.
 - State court decisions regarding these laws are not expected anytime soon.
- Major simplification efforts by some states are needed (i.e., Colorado, Louisiana), but most companies are not in a position to ignore enforcement dates.



Impact to Companies



- Remote sellers are required to register and start collecting sales tax in states where they cross economic nexus thresholds.
- The states are not waiting for any further guidance.
- The states feel that they already were patient.
- This is a significant burden on many smaller to mid-size companies.



State Actions Post-*Wayfair*

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Sales Tax Economic Nexus Scorecard

37 states have sales tax economic nexus standards

- Revenue thresholds: >\$100K (29), >\$250K (4), >\$500K (4)
- Transaction thresholds: 200 (27), 100 (3), none (7)
- Measurement periods: current or previous calendar year (24), previous calendar year (6), rolling 12 months (10), rolling 4 quarters (1), “annually” (1)
- Enforcement dates: one pre-*Wayfair* (MA); most other states either use Oct. 1, 2018 (11) or Jan. 1, 2019 (6)

Sales Tax Economic Nexus Scorecard (Cont'd)

- 5 states have no sales tax (AK, DE, MT, NH, OR)
- 8 states with no sales tax economic nexus yet

Arkansas (Jan. 14) – H.B. 1002 would use a \$100,000 or 200 transaction test	Kansas (Jan. 23) – no known <i>Wayfair</i> bills
Arizona (Jan. 14) – high administrative complexity; no known <i>Wayfair</i> bills	Missouri (Jan. 9) – S.B. 46/50/189, H.B. 41 use a \$100,000 or 200 transaction test
Florida (Mar. 5) – no known <i>Wayfair</i> bills	New Mexico (Jan. 15) – H.B. 6 would use a \$100,000 test, destination sourcing
Idaho (Jan. 7) – uses referrer nexus, no known <i>Wayfair</i> bills	Virginia (Jan. 9) – S.B. 1083 would use a \$100,000 or 200 transaction test

Don't Forget About Use Tax Notice and Reporting

- Five primary states
 - Colorado
 - Louisiana
 - Oklahoma
 - Pennsylvania
 - Washington
- Steep penalties for noncompliance
- Some replaced by econ nexus; some concurrent



Getting Practical: What Companies Should Do

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The Big Question

- **Q.** What if my business meets a state's sales tax economic nexus threshold? Should I collect and remit by the enforcement date?
- **A.** Not necessarily. Many other issues should be considered first:
 - **Evaluate prior period nexus exposure.** Registering eliminates VDA eligibility.
 - **Ensure that you actually meet the threshold.**
 - ◇ Revenues: gross sales (SD), retail sales (MN), or taxable sales (ME); Measurement period
 - ◇ Number of transactions: one agreement, multiple invoices; monthly subscriptions
 - **Consider all state tax types,** incl. franch. tax impact of sales tax/SOS registration
 - **Ensure you understand the taxability of your goods/services.**
 - **Ensure you have the technology, processes, and capacity to comply.**
 - **The enforceability of the state's sales tax nexus law** is a valid consideration, but you must consider if your company is in a position to litigate the position.

Wayfair Risk Assessment Process

- Review 2017, 2018, and 2019 YTD sales by state and number of transactions
 - Actual number of transactions is ideal
 - May need to estimate based on average sales price
- Compare sales and number of transactions data to most recent economic nexus standards in each state
- Review nexus for prior periods (physical presence) and evaluate exposure
- Develop registration and remediation plan
- Prepare to register
- Register, collect, and remit
- Annual process review



How do you assess prior period nexus?

Sales Tax

- Physical presence
 - Travel by employees, independent contractors, sales agents
 - Property, trade shows
- Quantify exposure
 - Review taxability of each revenue stream

Other Tax Types: Income, Franchise, Gross Receipts

- Physical or economic presence
- Quantify exposure

Risk Mitigation



Risk Mitigation Approaches

There have historically been four approaches:

Back-file sales tax returns, with penalty waiver request

Use the state's voluntary disclosure agreement (VDA) process

Participate in tax amnesty, e.g., fall 2017 FBA initiative

Register and file prospectively only

Unfortunately, none of these permit a seller to avoid bearing the economic cost of uncollected sales tax

Collecting and not remitting tax generally involves criminal penalties

“Reach out and contact the state” – suggested by a SSTGB member

Same economic reality as a typical VDA

Frequently Asked Questions

- How will states find my company?
 - Many states are using data mining. For example, IN and WI paid third-party vendors for a list of leads, sent letters
 - CT, IL, NY, OH, OK, and PA are known to use data mining
- How will states get my company's money?
 - We have observed states issue levies and withdraw funds from companies' bank accounts in other states

Frequently Asked Questions (Cont'd)

- Does *Wayfair* affect other types of state taxes?
 - Yes. *Wayfair* has likely ended the debate about whether physical presence nexus is required for any state tax type.
 - In July 2018, Wells Fargo Bank booked a \$481M reserve relating to *Wayfair*-based income tax nexus issues.
 - More states are expected to enact “factor presence” nexus standards post-*Wayfair*; monitor closely
 - ◇ E.g., *Crutchfield Corp. v. Testa*, Ohio Supreme Court (2016)



Compliance Strategies

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Preparing to Register

- Determine filing requirements (nexus)
- Gather exemption documentation
- Compile company information in one location such as general business information, owner information, estimated monthly sales, etc.



Don't Forget About Drop Shipments

- Some states require state specific resale certificates for drop shipments.
- California and Florida are the largest.
- If state specific resale is not provided, vendor is required to charge tax even if the sale is ultimately for resale.
- Consider registering even if nexus isn't established.

Registration with States

- Prior to 2/1/19 registrations made through Streamline required registering in all 24 Streamline states. Selective registration is expected to be available beginning the week of 2/4/19.
- Some states require registration with the Secretary of State.
 - This may result in a requirement to file additional tax returns (i.e. income or franchise returns).
 - Filing with the SOS can sometimes be avoided by not filing online.
- Complete the entire registration. Items like SSNs are needed to process the registration.



Preparing to Comply



Put process in place to charge correct tax rate (software solution or manual process)



Determine taxability of revenue streams (software solution or manual process)



Evaluate and implement software solution if needed



Test your solution

Filing Considerations

Filing sales and use tax returns is a lot more complicated than people realize.

Reports provided by software providers do not always align with how to file a return.

Keeping up with different filing periods and estimated payment schedules can result in missed returns and payments.

Filing can take a significant amount of time each month. Can you handle this internally or should you outsource it?



Other Considerations



- Collecting exemption certificates in all states is recommended.
- Once registered for sales tax, the Company is on the radar for other tax types.
- Consider registering in states with notice reporting requirements, special drop shipment rules, and in states where you are close but not over filing thresholds.



Closing Comments

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Closing Comments

- Additional economic nexus guidance through Congressional action or by additional court rulings in the near future is unlikely.
- Most small to mid-size companies are greatly impacted by the Wayfair decision and need to review the impact the ruling has on their company.
- Establishing a process to collect and remit can be time consuming and require the input of multiple stakeholders so time is of the essence.
- The impact of other state and local taxes on any sales tax registration decision should not be overlooked.

Sales tax is not an expense to your company unless you fail to collect and remit it.





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