

What Now? The *Wayfair* Decision and Its Effect for Nonprofits

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- More than 5,400 employees
- Offices coast to coast
- Serving over 6,000 nonprofits



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Speaker Introductions

Karen Gries, Principal

- More than 28 years of experience in nonprofits
- Provides services to a variety of tax-exempt organizations, including credit unions, charities, foundations and others

Kathleen Thies, Director

- More than 13 years of experience in state and local tax
- Provides services in income and franchise state tax issues for multinational companies and flow-through entity structures
- Licensed attorney for the State of Illinois

Learning Objectives

- At the end of this session, you will be able to:
 - Describe the key implications of the ruling in *South Dakota v Wayfair*
 - Recognize the economic nexus statutes and reporting and notification requirements that are currently in place
 - Identify the steps you should take to prepare for the states' responses to the decision



State Tax Nexus

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Nexus – A Four-Step Analysis

- Where does the organization have nexus?
- What taxes can be imposed on the organization once nexus is established?
- Is there a need to register as a nonprofit or apply for a separate state nonprofit determination?
- How does the organization comply?

What Activities Create Nexus?

- Individuals/activities in other states
- Professors conducting online training from their in-home office
- Editors of a trade publication working from their in-home office outside of the organization's home state
- Travel outside one's home state to run or participate in charitable functions
- Speaking engagements
- Research assignments
- Development officer's travel to various states

What Taxes Apply Once Nexus is Determined

- Generally:
 - Most states will accept the federal tax exempt status under IRC Section 501 for income tax purposes
 - Unrelated business income tax applies in many states – separate registration may be required
 - Separate registration is required for Sales and Use Tax (purchases) to receive tax exempt status
 - Franchise and taxes on capital generally will not apply if tax exempt for state purposes



State Taxation of Nonprofits

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Taxation of Nonprofits

Income/Franchise/Gross Receipts Tax

- Most states provide an exemption from income tax for nonprofit organizations.
- The exemption does not generally extend to “non-income based” taxes.

- ◇ Washington B&O Tax
- ◇ New Mexico Gross Receipts

Sales and Use Tax

- Many states provide an exemption from sales and use taxes for purchases by nonprofit organizations.
- The exemption does not extend to sales by the organization to an ultimate purchaser.

Number One Sales Tax Rule For All States

- All sales of tangible personal property and enumerated services are taxable unless a specific exemption exists
 - Does the state recognize the IRS tax exempt status of the nonprofit for sales and use taxes?
 - For nonprofits, does this mean purchases are exempt from sales and use tax?
 - Is the nonprofit required to collect tax on the sale of goods?

Nonprofit Purchases

- Nonprofit purchases are presumed taxable unless a specific exemption exists
- The most common exemption is for the purchase of goods used in the charitable purpose
 - software, office equipment & furniture, supplies, etc.
- Exemption certificates should be issued to suppliers where appropriate
- Don't assume that because no tax was assessed on an invoice that the product is exempt

Sales By Nonprofits

- States consider sales of tangible personal property as taxable
- Even nonprofits may be required to collect sales tax on sales of tangible personal property
- Exemptions
 - Fundraising
 - De minimis sales
 - Product itself is exempt



Wayfair

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What is *Wayfair*?

- *South Dakota v. Wayfair, et. al.* is a 5-4 U.S. Supreme Court decision issued on June 21, 2018.
 - The Court overturned the physical presence requirement for sales and use tax collection obligation 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, but sent the case back to SD to address this

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 in to a state where it does not maintain a physical presence:
 - Online sales
 - Purchase orders
 - Telephone orders
 - Automatic replenishment order systems – supply chain management
- *Wayfair* does not only apply to Internet sellers!

The Road to The Supreme Court

- Physical presence: *Quill* (1992)
- Streamlined Sales and Use Tax Agreement (2000)
- Affiliate nexus (many years)
- Click-through nexus (2008)
- Use tax notice and reporting (2010 – current), *DMA v. Brohl* (2015)
- NCSL model laws: marketplace providers, referrers, remote sellers (2016)
- In-state software/content distribution network (“cookie nexus”) (2017)
- Marketplace seller (“Fulfilled by Amazon”) nexus (Fall 2017)
- **Economic nexus – *Wayfair*** (June 2018)

Wayfair – The Court Decision

- The Court overturned *Quill*
 - It acknowledged that Congress could take action... which has started
- The Court did not decide whether SD'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.* (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 its 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
 - South Dakota 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

Post-Wayfair: The Next Few Months

- Back to South Dakota
 - **Late July:** the Court remands the case to the SD Supreme Court
 - **Late July to early August:** the SD Supreme Court sends the case to the SD Circuit Court.
 - **August to September:** the SD Circuit Court may dissolve the injunction and/or conduct further proceedings.
- Settlement Possibility?
 - Benefit to South Dakota: it would lift SD's injunction and allow immediate collection, avoid costly litigation
 - Benefits to parties: negotiate prospective collection, no penalties; confidentiality likely, which offers leverage with other states

Post-Wayfair: The Next Few Months

- Congressional Action?
 - July 24/25: House Judiciary Committee took testimony
 - Chairman Goodlatte opposes *Wayfair* but retires in November
- State Self-Regulation?
 - *Opposes* Congressional action: MTC, some Judiciary Committee members
 - MTC outreach for working group: FTA (yes), NCSL, SSTGB, NGA (tbd)
 - ◇ eCommerce trade groups (e.g., NetChoice, ACMA) want to understand states' objectives and start a dialogue, without further politicizing the issue
 - ◇ Efforts to avoid “outlier” state legislation, which may attract Congress' attention
 - *Supports* Congressional action: NCSL

Post-Wayfair: The Next Few Months

- MTC simplification measures suggested by *Wayfair*'s counsel
 - a single tax rate for remote sales—no greater than a weighted average of state and local rates;
 - uniform definitions of taxable products;
 - a precise definition of “physical presence;”
 - a prohibition on retroactive back-taxes on sellers who lacked this definition of “physical presence;”
 - a reasonable small business exception; and
 - vendor protection from consumer error in computing sales tax

Post-Wayfair: Multistate Enforcement Dates

- 25 states have enacted a sales tax economic nexus rule
- Enactment and enforcement dates are very different
 - Many states' economic nexus laws were enacted in 2016 using model legislation from the National Conference of State Legislatures (NCSL)
- Enforcement dates vary dramatically
 - Enforcement suspended due to court order: IN, SD, TN
 - Dates range from Oct. 1, 2017 to Jan. 1, 2019
 - Many states use **October 1, 2018**
 - ***UPDATE - SST July 19 meeting : businesses want a chart that lists all dates***

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 outside of a state's voluntary disclosure agreement (VDA) process eliminates VDA eligibility.
 - **Ensure that you actually meet the threshold.**
 - **Consider all state tax types.**
 - **Evaluate the enforceability of the state's sales tax nexus law.** The farther it is from the "blueprint", its more questionable its enforceability becomes.
 - **Ensure you understand the taxability of your goods/services.**
 - **Ensure you have the technology, processes, and capacity to comply.**



The Ins-and-Outs of Sales Tax Economic Nexus Laws

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What States Have Sales Tax Economic Nexus Laws?

- 25 states have a sales tax economic nexus standard
- South Dakota used >\$100k sales *or* 200+ transactions
- Survey of sales thresholds:
 - >\$100K (18 states, incl. SD), >\$250K (4); >\$500K (3)
- Survey of transaction volume thresholds:
 - 200+ (19 states, incl. SD); 100+ (2); none (4)
- Most states require either (an “or” test)
 - CT and MA need both; MN’s \$100K threshold needs 10+ transactions
 - **Question:** Single remote sale of \$5M jewel to a CT or MA purchaser?

How Do I Apply These Thresholds?

- Measurement period
 - Current or prior calendar year (13); rolling 12-month period (8); prior calendar year (4)
 - ◇ **Question:** Single remote sale of \$5M jewel to “prior calendar year” state?
- Taxable sales or all sales
 - Retail sales: of TPP (3), of multiple specific items (1), of all items (2)
 - All sales (14): all taxable sales (5)
 - SST July 19 meeting: states are getting calls for clarity about this
- Solicitation requirement
 - Regular or systematic solicitation (6)

How can I tell if a state's law is likely enforceable?

- Justice Kennedy looked at the following aspects of SD law:
 - Threshold size (>\$100K sales or 200+ transactions)
 - Not retroactive
 - Collection simplification measures in place (for SD, SST full member)
- Applying these three criteria:
 - Threshold size: compare to SD's
 - Retroactivity: per SSTP July 19 meeting, MA, RI, and HI are problems
 - Collection simplification
 - ◇ Justice Kennedy: “various plans already in place to simplify collection”
 - ◇ South Dakota is an SST member. What about other “plans” (Alabama SSUT)?

How Important is SST Membership Now?

- ***SST Governing Board Emergency Meeting – St. Paul, July 19***
- 24 member states, 17 have economic nexus
- Sample of issues discussed:
 - Is SST membership necessary, or are other “plans” good enough?
 - Should SST loosen its historical “all or nothing” registration process?
 - Desire for central chart of thresholds (e.g., taxable sales v. all sales)
 - What is a “voluntary” SST seller after *Wayfair*?
- July 31: SSTGB will renegotiate contracts with CSPs
 - Pre-*Wayfair*, “voluntary” sellers had software paid for by the state



Industry-Specific Implications of *Wayfair*

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Nonprofit-Specific Implications

- **Conferences**
- **Bookstores and online sales**
- **Data processing**
- **Radiology interpretations**
- **Subscriptions**
- **Billing services**

Industry-Specific Implications (Continued)

- **Services**

- Sourcing rules for services generally look to where the benefit is received
- States like South Dakota, New Mexico, and Hawaii tax most services
- May need to research additional states to determine if the service is taxable (e.g., data processing)

Industry-Specific Implications (Continued)

- **High Technology**

- States' rules about the taxability of software vary dramatically, depending on issues such as the delivery method, server location, customer location, and the type of software.
- Must evaluate not only the taxability of software but also the taxability of ancillary services, i.e. installation.



How CLA Can Help: *Wayfair* Checkup

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Sales Tax Nexus Assessment – *Wayfair* Checkup

- Historical nexus study to establish your overall state nexus profile
- Quantification of past exposure, including sales tax taxability analysis
- Risk mitigation of past exposure, including VDAs
- Analyzing how states' economic nexus thresholds apply to your facts
- Sales tax compliance outsourcing services
- Use tax notice and reporting analysis
- Audit and appeals assistance
- Sales and use tax refund (reverse sales tax audit)



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