The *Wayfair* Decision and Its Effect on Sales Tax for Technology and Emerging Companies

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor

We promise to know you and help you.

Disclaimers

The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, or tax advice or opinion provided by CliftonLarsonAllen LLP to the user. The user also is cautioned that this material may not be applicable to, or suitable for, the user's specific circumstances or needs, and may require consideration of non-tax and other tax factors if any action is to be contemplated. The user should contact his or her CliftonLarsonAllen LLP or other tax professional prior to taking any action based upon this information. CliftonLarsonAllen LLP assumes no obligation to inform the user of any changes in tax laws or other factors that could affect the information contained herein.

Housekeeping

- If you are experiencing technical difficulties, please dial: **800-422-3623**.
- **Q&A session will be held at the end of the presentation.**
  - Your questions can be submitted via the **Questions Function at any time during the presentation.**
- The **PowerPoint presentation**, as well as the **webinar recording**, will be sent to you within the next 10 business days.
- For future webinar invitations, subscribe at CLAconnect.com/subscribe.
- Please complete our online survey.

CPE Requirements

- Answer the polling questions
- Remain logged in for at least 50 minutes
- If you are participating in a group, complete the CPE sign-in sheet and return within two business days
  - Contact webmaster@CLAconnect.com
- Allow four weeks for receipt of your certificate; it will be sent to you via email from support@lcvista.com.

- **This webinar, once recorded, has not been developed into a self study course. Therefore, watching the recording will not qualify for CPE credit.*

About CLA

- A professional services firm delivering integrated:
  - Wealth advisory
  - Outsourcing
  - Audit, tax, and consulting services
- CLA serves over 1,500 technology and startup companies

110+
locations

60+
years of quality, service, and experience

5,400+
employees including **700+** Principals

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC.

Speaker Introductions

Dustin Hubbard, Principal

- West Region and Tech Industry State and Local Tax (SALT) Leader
- More than 14 years of experience in SALT

Patrick Smith, Principal

- Technology Industry Group, Tax Leader
- Over 20 years experience working with technology companies

Steven Jensen, Manager

- Pacific Northwest SALT Leader
- 20 years of multistate tax experience

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 sales tax 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

Federal Tax Reform – Quick Update

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Federal Tax Reform – Quick Update

- Corporation income tax rate change
  - Rate Reduction from 35% to 21%
    - ◊ Large NOLs have become less valuable
- Repeal of Alternative Minimum Tax for Corporations
  - R&D tax credit implications
  - NOL implications

Federal Tax Reform – Quick Update

- Net Operating Losses
  - Losses that arise in tax years after 12/31/2017 will have an unlimited carryover and no carryback period.
  - Utilization of NOL is now 80% of taxable income
  - AMT impact – unintended consequences?
    - ◊ NOLs prior to 2018 expire under original schedule
    - ◊ NOLs prior to 2018 are not subject to 80%

Federal Tax Reform – Quick Update

- Research and Development
  - Capitalization of R&D expense required starting in 2022
  - Credits historically have been limited to TMT or Tentative Minimum Tax under the AMT. With the repeal of AMT this is not longer a limitation.
- Limitation on interest deductibility
  - Limited to 30% of Adjusted Taxable Income
    - ◊ Earnings before depreciation, interest, tax and amortization

Federal Tax Reform – Quick Update

Disallowed Business Interest Expense

- Interest expense limited to interest income plus 30% of remaining adjusted taxable income. Adjusted taxable income is taxable income excluding:
  - any nonbusiness income, gain, deduction or loss
  - business interest and business interest income
  - any net operating loss (NOL) deduction under section 172
  - any deduction allowed under section 199A (not applicable to C-Corp)
  - any deduction allowable for depreciation, amortization, or depletion (only for tax years beginning before 1/1/22.)

Federal Tax Reform – Quick Update

- Meals and Entertainment
  - Entertainment Expense: Non-Deductible!
    - ◊ Transportation passes and parking fringes disallowed
    - ◊ Social, athletic and sporting clubs treated as entertainment
  - Employer-provided eating facility limited to 50%
    - ◊ Pre-TCJA: 100% Deductible
  - Meals consumed on work travel remain 50% deductible
  - Business meals remain 50%

State Tax Nexus

Nexus – A Four-Step Analysis

- Where does the company have nexus?
- What taxes can be imposed on the company once nexus is established?
- Is there a need to register?
- How does the company comply?

What Activities Create Nexus for Sales Tax Purposes?

- Individuals/activities in other states
- Property in other states
  - Watch for the cookie monster…
- Programmers/employees/contractors working from their in-home office
- Employees/contractors doing installation, customer service, etc. in another state
- Employee/contractors travel outside home state for work related projects or tasks
- AND NOW… Sales Thresholds

What Taxes Apply Once Nexus is Determined

- Generally:
  - Income taxes for income earned from within the state
  - Franchise and taxes on capital
  - Sales Tax on sales to customers unless not taxable for another reason
  - Use Tax on purchases used in the state unless exempt for another reason

Wayfair

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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,
  - The "fairly related" prong result is yet unknown
- 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 covers 30% of the U.S. population: not CA, TX, NY, IL, PA, or FL

Post-*Wayfair:* The Next Few Months

- Back to South Dakota
  - **August to September:** the SD Circuit Court may dissolve the injunction against the parties of the case
  - **September:** SD Legislature dissolved injunction against all other taxpayers effective November 1, 2018
- 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: 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

- 27 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: TN
  - Dates range from Sept. 1, 2018 to Jan. 1, 2019
  - Many states use **October 1, 2018**

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

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

What States Have Sales Tax Economic Nexus Laws?

- 27 states have a sales tax economic nexus standard
- South Dakota used >$100k sales *or* 200+ transactions
- Survey of sales thresholds:
  - >$100K (19 states, incl. SD), >$250K (5); >$500K (3)
- Survey of transaction volume thresholds:
  - 200+ (21 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 (15); rolling 12-month period (8); prior calendar year (4)
- 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*

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Industry-Specific Implications

- **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, updates, maintenance agreements.

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 (ontinued)

- **Manufacturers**
  - Must register and collect in new states
  - Must collect exemption certificates in new states
  - The sale of one large machine could exceed an economic threshold
  - Additional vendors will now be charging sales tax on purchases
- **Wholesalers**
  - May require collection of resale exemption certificates in new states to which goods are shipped but where the wholesaler has no physical presence

How CLA Can Help: *Wayfair* Checkup

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Sales Tax Nexus Assessment – *Wayfair* Checkup

- Historical nexus study to establish your overall state nexus profile
  - For all taxes (sales, income, Business and Occupation, Commercial Activity, etc.)
- 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)

CLAconnect.com

Questions?

Dustin Hubbard
dustin.hubbard@CLAconnect.com | 303-793-1425
Patrick Smith
patrick.smith@CLAconnect.com | 425-250-6087
Steven Jensen
steven.jensen@CLAconnect.com | 425-250-6055

To receive future webinar invitations, subscribe at CLAconnect.com/subscribe.

linkedin.com/company/cliftonlarsonallen

facebook.com/cliftonlarsonallen

twitter.com/CLAconnect

youtube.com/CliftonLarsonAllen