

State Sales Tax on Drop Shipments: Navigating Various States' Rules on Registrations and Exemptions

THURSDAY, NOVEMBER 9, 2017, 1:00-2:50 pm Eastern

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State Sales Tax on Drop Shipments

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State Sales Tax on Drop Shipments: Navigating Various States' Rules on Registrations and Exemptions



State Sales Tax on Drop Shipments: Concepts & Issues

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- FUNDAMENTAL CONCEPTS
- PROBLEMATIC SCENARIOS & ISSUES



State Sales Tax on Drop Shipments: Fundamental Concepts

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- What is A Drop shipment?
 - Three parties / Two separate transactions
 - A purchase by Primary Purchaser (PP) for resale to their Customer and shipment of tangible personal property from a Supplier directly to the Primary Purchaser's Customer, at the direction of the Primary Purchaser
 - Can be subsequent resale by Customer



State Sales Tax on Drop Shipments: Fundamental Concepts

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- What is A Drop shipment?
 - In E-Commerce, enables retailers to purchase individual orders from suppliers and have suppliers fulfill to customer
 - Instead of purchasing a large amount of inventory, you simply partner with a drop shipping supplier and list their merchandise for sale.



State Sales Tax on Drop Shipments: Fundamental Concepts

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- TYPICAL SALES TAX TREATMENT OF A SIMPLE DROP SHIPMENT
 - When all three parties are in the same state, the Primary Purchaser furnishes a resale certificate to the Supplier, rendering the first sale a nontaxable transaction.
 - The Primary Purchaser then collects sales tax on behalf of the state on the secondary sale to its Customer.
 - Customer may also issue a resale certificate for subsequent resale, or exemption certificate for other exempt use



State Sales Tax on Drop Shipments: Fundamental Concepts

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- TYPICAL SALES TAX TREATMENT OF A COMPLEX DROP SHIPMENT
 - When NOT all three parties are in the same state, the tax treatment gets more complex and varies by state and facts.
 - BIGGEST ISSUE - assuming transaction situated to Customer state
 - NEXUS, NEXUS, NEXUS
 - who has it and what does state say about their obligations



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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- ONLY PRIMARY PURCHASER IN CUSTOMER STATE
 - When only Primary Purchaser and Customer are in Customer's state, this does not present a problem, as the Wholesaler does not have a sales tax compliance obligation and does not seek a resale certificate.
 - Prudent Supplier will collect resale certificate anyway
 - Primary Purchaser collects sales tax from Customer



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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➤ ONLY CUSTOMER IN CUSTOMER STATE

- When only Customer is in Customer's state, this does not present a problem, as the Wholesaler does not have a sales tax compliance obligation and does not seek a resale certificate.
- Primary Purchaser does not have a sales tax compliance obligation and does not collect sales tax from Customer
- Customer has obligation to remit use tax



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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- ONLY SUPPLIER AND CUSTOMER IN CUSTOMER STATE
 - When only the Supplier and the Customer are in Customer's state, this present a problem
 - Wholesaler has obligation to obtain resale certificate from Primary Purchaser or collect sales tax
 - Primary Purchaser does not have resale certificate for destination state
 - Primary Purchaser does not have a sales tax compliance obligation and cannot collect sales tax from Customer



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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- ONLY SUPPLIER AND CUSTOMER IN CUSTOMER STATE: QUESTIONS?
 - Does Supplier have nexus? Supplier is obligated to collect tax from the PP on the drop ship transaction unless the PP can provide exemption documentation (deemed acceptable by the ship-to state).
 - Does ship-to state allow PP to issue home state certificate? If so, no problem.
 - Does ship-to state allow PP to issue other documentation? If so, no problem.



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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- ONLY SUPPLIER AND CUSTOMER IN CUSTOMER STATE: QUESTIONS?
 - Where does title transfer? If it transfers in other state, does PP have nexus in that state? Does Supplier? Common carrier used?
 - How does the transaction state treatment drop-shipments? Can PP provide certificate or alternative document?
 - Is Customer claiming an exemption? Resale? If so, many states allow Customer to pass through certificate to Supplier.
 - Is the Primary Purchaser a foreign entity? If so, does state accept other documentation as proof of resale?



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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➤ OTHER NEXUS CONSIDERATIONS

- Just because PP is not registered in Customer state does not mean that it does not have nexus and should not be registered.
- Does PP have inventory maintained in state (e.g., Amazon FBA program)?
- Does PP send sales reps into state sporadically?
- Does PP have contractors or third party service reps in state?
- Does PP pick up merchandise or do anything in the state, through employees or reps?



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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➤ OTHER NEXUS CONSIDERATIONS

- To Increase the Number of Taxpayers, Trend is To Enact Far-Reaching Nexus Standards
- Click-Through Nexus: AR, CA, CT, GA, IL, KS, ME, MI, MN, MO, NJ, NY, NC, RI, TN, VT
- Affiliate Nexus: AR, CA, CO, GA, IL, IA, KS, ME, MO, NY, OK, SD, TX, UT, VA, WV.
- These states adopted a Remote Seller Standard: DC, LA, MD, NM, ND, PA, SC, TN, WA



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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➤ OTHER NEXUS CONSIDERATIONS

- Often, when I am brought in to evaluate drop-shipments, we determine (1) PP has nexus it did not realize it has, or
(2) there is an exception to certification requirement
- Does registration for sales tax / resale certification create income tax obligations? Typically only if taxpayer exceeds income tax nexus thresholds.



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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➤ DOCUMENTATION REQUIREMENTS

- Invoice - should indicate Ship To location and Shipping Terms, as these dictate what state certification rules apply
- Resale Certificates - What is acceptable?
 - Ship-to cert with Ship-to account number (CA, DC, MD)
 - Ship-to state cert with PP “home state” tax account number (MI, NJ, NY, TX, VA)
 - MTC Multi-jurisdictional Resale Certificate (ME, OK, RI, UT)
 - SSTP Exemption / Resale Certificate (WA)



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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➤ DOCUMENTATION REQUIREMENTS

- Resale Certificates - What is acceptable?
 - Ship-to state cert with note that purchase is for resale, or “No nexus” statement on PP letterhead/ invoice (FL, LA)
 - Home State cert with home state account (NJ, VT, VA)
 - Other documentation - for example, an invoice from the PP to its customer, showing that the item was actually resold, along with a statement from PP explaining why it had not obtained a resale number and certifying that the purchase was a purchase for resale (IL, MI, VA, WV)



State Sales Tax on Drop Shipments: Problematic Scenarios / Issues

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➤ DOCUMENTATION REQUIREMENTS

- Resale Certificates - Exceptions:
 - Customer is reselling or using for exempt purpose - nearly every state permits the PP to provide evidence that their transaction and/or subsequent purchase is for resale
 - Transfer of title in another state
 - FL provides that this is not a taxable sale
 - What about state in which title transfers?
 - Consumer has ultimate use tax obligation



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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- SUPPLIER RESPONSIBILITIES
- PRIMARY PURCHASER RESPONSIBILITIES
- AUTOMATION
- DEALING WITH AUDITS



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ SUPPLIER RESPONSIBILITIES

- When must tax be collected on drop-shipment sales?
 - Understand the scenarios under which Suppliers must collect tax
 - Can this tax be passed on to the Primary Purchaser?
- Is resale support acceptable?
 - Required support varies by state and may be dependent upon Primary Purchaser registration



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ SUPPLIER RESPONSIBILITIES

- On what tax base price is the sales tax computed?
 - Supplier's sales price to Primary Purchaser (AZ, CO, MD, MN, NJ, TN, TX, VA)
 - Primary purchaser's sales price to Customer (MA)
 - Other methods - CA - dropshipper owes tax on the true retail price, or dropshipper (wholesale) price + 10% markup
- Work with tax professionals to obtain a matrix of state rules and develop drop-shipment policy/procedures



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ PRIMARY PURCHASER RESPONSIBILITIES

- Will drop-shipping Suppliers charge sales tax on a sale if unable to provide valid exemption support?
 - May drop-shipping Suppliers and Primary Purchaser accept resale certificate of customer if it will be reselling?
- Have relationships with drop-shipping Suppliers created nexus in any state?
 - Is the drop-shipping Supplier an agent of the Primary Purchaser, by virtue of fulfillment or any other activities conducted on behalf of Primary Purchaser?



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ AUTOMATION TOOLS

- Create, validate, store, manage certificates
- Integrate with ERP, accounting, tax decision and POS systems
- Avalara CertCapture, Vertex ECM, ONESOURCE TCM
- Some companies implement “home grown” platforms into their ERP, to scan and manage certs and interface with billing and tax systems



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ PREPARING FOR AUDITS

- Establish policy and procedures now
 - Procedures when making sales, invoices
 - Maintaining documentation
 - Automation
- Audits are not the only risk - exposure discovered during due diligence
- Stay Current - laws are constantly evolving



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ DEALING WITH AUDITS

- Suppliers - Was proper exemption evidence maintained? If tax was collected, at what sales price?
- Primary Purchaser - Have Supplier activities created nexus? Is there any other physical presence?
- Customers - Do you have documentation that Supplier collected tax from Primary Purchaser? Did you self-report?



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ DEALING WITH AUDITS

- Audit Yourself - Review the Items to be Audited, Gather Certificates & Documentation, Form Determination & Positions and Review Compliance and Audit History
- Initial Meeting & Workplan: Set the Tone, Introduce auditor to your Company and record-keeping / compliance processes, Discuss use and timing of information, and Set a date for the audit to conclude
- Manage expectations - how long does the auditor intend to be on-site; timing for providing information



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ DEALING WITH AUDITS (cont'd)

- Discuss how to handle Missing or Insufficient Documentation
- Discuss how to handle overpayments
- Discuss Sampling Methods and Avoid Signing Agreements
- Document all communications and Request that the Auditor issue all Request for Information in Writing as well
- Involve your tax advisor
- Waivers of the Statute of Limitations



State Sales Tax on Drop Shipments: Ongoing Compliance Demands

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➤ DEALING WITH AUDITS (cont'd)

- Based on Initial Conference, draft Audit Plan & Guidelines and provide to auditor - only provide info requested
- Encourage face to face meeting for all Q&A, then document
- Request Updates
- Review Workpapers at every step of process
- Overpayments & Offsets
- Closing Conference and Appeals
- Remedial Efforts - make sure you fix the audit errors



State Sales Tax on Drop Shipments: States That Pose Specific Issues

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- STREAMLINED SALES TAX
- PROBLEMATIC STATES



State Sales Tax on Drop Shipments: States That Pose Specific Issues

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➤ STREAMLINED SALES TAX

- Sales tax simplification: uniform def'ns; uniform sourcing; state-level administration; uniform exemption certificate.
- Full members have adopted laws consistent with the SSUTA: AR, GA, IA, IN, KS, KY, MI, MN, NE, NV, NJ, NC, ND, OH, OK, RI, SD, UT, VT, WA, WV, WI, & WY (TN is associate member)
- SSUTA member states generally permit Suppliers/Drop-Shippers to accept SSUTA resale certificate or any other acceptable information evidencing qualification for the resale exemption



State Sales Tax on Drop Shipments: States That Pose Specific Issues

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➤ CALIFORNIA

- Only valid CA exemption certificate accepted
- Supplier should collect tax on PP's retail selling price or Supplier's selling price with imputed markup

➤ CONNECTICUT

- Only valid CT exemption support accepted
- If title transfers out of state, CT does not tax
- Supplier collects tax on the PP's sales price to the Consumer, or Supplier's price and customer responsible for the difference



State Sales Tax on Drop Shipments: States That Pose Specific Issues

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➤ FLORIDA

- Only valid FL exemption certificate accepted
- However, Suppliers may not be required to collect tax when the Supplier, the inventory and Primary Purchaser are located outside of FL
- Otherwise, Supplier must charge sales tax to Primary Purchaser

➤ HAWAII

- General Excise Tax - Supplier gross receipts taxed at retail rate unless valid HI exemption certificate obtained



State Sales Tax on Drop Shipments: States That Pose Specific Issues

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- MASSACHUSETTS
 - Only valid MA exemption certificates accepted
 - Supplier must collect tax based on Primary Purchaser's retail selling price to Customer
- MARYLAND, MISSISSIPPI, NEBRASKA, PENNSYLVANIA, SOUTH DAKOTA, TENNESSEE & D.C.
 - Only valid Customer state exemption certificates are accepted, so Primary Purchaser must be registered in the Customer state
 - Suppliers collect tax on their selling price to Primary Purchaser



State Sales Tax on Drop Shipments: States That Pose Specific Issues

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➤ AUDIT ISSUES IN PROBLEM STATES

- Audit practices in states that don't accept another state's resale certificate?
 - Example: Retailer with CA nexus has separate affiliated Online Seller with no CA nexus. Online seller directs affiliated CA Retailer to drop-ship to its Customer. CA BOE deems CA Retailer to be retailer, who owes tax on the retail price to the customer
- States may assert that drop-shipper is deemed agent of Primary Purchaser, creating nexus for Primary Purchaser