State Tax Guidance on Remote Sellers Post-Wayfair: State Law on Economic Nexus, Compliance Challenges

TUESDAY, DECEMBER 11, 2018, 1:00-2:50 pm Eastern

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THE *WAYFAIR* DECISION AND ITS IMPACT

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Discussing *Wayfair's* Profound Impact

- *South Dakota v. Wayfair Inc.*, 138 S.Ct. 2080 (2018) – the most significant state tax case to come before the U.S. Supreme Court in decades:
  - What the Court held, and what it did not resolve;
  - Post-*Wayfair* enforcement by the States; and
  - Some practical considerations for state tax compliance, including our thoughts on both sales/use and other types of states taxes.

The "Physical Presence" Standard

- For more than 50 years, state sales and use tax laws were subject to Commerce Clause review based on the "physical presence" standard:
  - In *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), the Supreme Court held that a company whose only contact with a state is communicating with customers by mail or phone and delivering products via common carrier cannot be required to collect and remit state sales/use tax.
  - The Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) reaffirmed *Nat'l Bellas Hess* under the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), holding that a company must have a physical presence in a state, either directly or through third-party representatives, in order for the state to compel the company to collect and remit sales/use tax.
  - The *Quill* standard protected multistate businesses from being forced to comply with sales and use tax requirements in the more than 10,000 state and local taxing jurisdictions in the United States.

South Dakota Challenges *Quill*

- In 2016, South Dakota contested the continuing vitality of the physical presence standard.
- The State enacted an "economic presence" standard for sales tax collection.
  - Retailers with no physical presence in South Dakota (*i.e.*, protected by *Quill*) required to collect South Dakota sales tax if they have:
    - $100,000 in annual sales; or
    - 200 transactions during the calendar year.
- The objective was to create a case for review of the *Quill* standard by the U.S. Supreme Court.

South Dakota Challenges *Quill*

- Early in 2017, South Dakota conceded summary judgment in Circuit Court.
  - State was uninterested in defendants' actual business practices – it made no factual record.
  - Goal was to tee-up the central legal issue.
- South Dakota's Supreme Court affirmed the judgment at the urging of the State.

South Dakota Challenges *Quill*

- State filed for a writ of *certiorari* in October 2017, seeking review of whether the U.S. Supreme Court should abrogate *Quill's* physical-presence requirement.
- South Dakota was courting Justices Kennedy, Gorsuch, and Thomas:
  - Justice Kennedy called for a case to review *Quill* in his concurrence in *Direct Mktg. Ass'n v. Brohl*, 135 S.Ct. 1124 (2015);
  - South Dakota's petition mentioned these Justices *44 times.*
- In January 2018, the Supreme Court granted the State's *cert.* petition.

SCOTUS Tackles *Wayfair*

- State attacked the physical presence rule as critically flawed, asserting it:
  - Had no basis in dormant Commerce Clause jurisprudence;
  - Was out-of-date in the Internet era;
  - Served no purpose in protecting commerce from undue burdens, because software purportedly eliminates them;
  - Caused States to lose billions in tax dollars; and
  - Gave remote sellers an unfair advantage over their in-state competitors that collected the tax.

SCOTUS Tackles *Wayfair*

- Respondents' arguments sought to dispel the Court's likely assumptions about remote sales tax and focused on the consequences of overturning *Quill*.
  - Burdens, burdens, burdens – state sales tax systems are still unduly complex;
  - Software addresses only certain aspects of multistate sales tax compliance, and those imperfectly;
  - Under principles of *stare decisis,* there was no "special justification" for overturning longstanding precedent; and
  - Congress is the body with the power and the expertise to balance the competing claims.

SCOTUS Tackles *Wayfair*

- Many call *Wayfair* the most significant state tax case of the past 25 years.
- The case generated enormous national interest:
  - 40 *amicus curiae* briefs were filed;
  - More than 100 non-party *amici* participated;
  - The United States, over 40 other States, and every major state and local government association in the nation weighed-in;
  - Respondents garnered the support of 25+ *amici*, including trade associations, tax groups, remote sellers and practitioners.

Oral Argument Surprises

- With reversal largely expected, many observers were taken aback by the tone and direction of oral argument.
  - Justice Sotomayor began the hearing by putting several challenging questions to the South Dakota Attorney General.
  - When asked about the minimum level of contact for nexus, both the South Dakota AG and the U.S. Solicitor General said "one sale" would be enough.
  - Several Justices voiced concern about the consequences of overturning *Quill*, asking, why not leave it to Congress?
  - Justice Breyer indicated the close division among members of the Court, telling the parties: "You cannot both be absolutely right."

Oral Argument Surprises

- Support for the State came from some expected, and some unexpected, sources.
  - Justices Kennedy and Gorsuch, as anticipated, critiqued the retailers' position;
  - But it was Justice Ginsburg who was the first to intervene with a question sympathetic to South Dakota.
- At the gavel, the case was too close to call.

The Five Justice Majority

- For the retailers, securing the votes of Justices **Kennedy**, **Gorsuch**, and **Thomas** was always highly unlikely.
- Focus was on winning five of the remaining six, but the Respondents fell one short.
- Justice **Ginsburg** was more sympathetic to the State than expected.
- Justice **Alito** arguably proved to be the swing vote.

The *Wayfair* Decision

- On June 21, 2018, the United States Supreme Court issued a 5-4 decision, authored by Justice Kennedy, holding:
  - The Court's prior decisions in *National Bellas Hess* and *Quill* are overruled.
  - The "physical presence" test for state sales and use tax is "unsound" and an "incorrect interpretation of the Commerce Clause."
- Court further explained that a company has nexus when it "avails itself of the substantial privilege of carrying on business" in a jurisdiction.
- The decision also makes clear that fundamental Commerce Clause principles apply to state tax laws.
- Dissent (Chief Justice Roberts, joined by Justices Breyer, Kagan, and Sotomayor) focused on *stare decisis* and the role of Congress.

The *Wayfair* Decision

- Court held that the physical presence rule of *Bellas Hess* and *Quill* was incorrect both "as first formulated and as applied today."
- Court, however, did not attempt to craft a new bright line rule for state sales tax, concluding that the Commerce Clause favors a "sensitive, case-by-case analysis of purposes and effects."

The *Wayfair* Decision

- Court validated the four prong test of *Complete Auto Transit*.
  - This long-standing test for the constitutionality of state tax laws continues to apply.
  - *Wayfair* sets forth a new interpretation of the "substantial nexus" prong.
- Court also made clear that core principles of Commerce Clause jurisprudence apply to state tax laws:
  - States may not discriminate against interstate commerce; and
  - States may not unduly burden interstate commerce.

New "Substantial Nexus" Standard

- Standard of "substantial nexus" described by the Court is likely applicable to *all* types of state tax, because the *Complete Auto* test applies broadly.
  - Taxpayer has substantial nexus when it "avails itself of the substantial privilege of carrying on business" in a jurisdiction.
  - Test may be satisfied by, among other things, sufficient "economic and virtual contacts."
  - Physical presence remains relevant to "availment" test, but may not be sufficient, in an of itself.

What Are "Economic Contacts"?

- Court's *Wayfair* decision does not clearly describe the scope of "economic and virtual contacts," but certain principles are clear.
- Economic contacts exist when a retailer has significant sales or transactions for delivery into the state.
  - Court viewed South Dakota's standards of $100,000 in sales or 200 thresholds as sufficient.
  - But the Court did not address a floor or relative levels across states (and localities) of different size and economic output.

What Are "Virtual Contacts"?

- "Virtual contacts" are perhaps even less clear:
  - Without any factual basis, the Court deemed the large retailers in *Wayfair* to "undoubtedly maintain an extensive virtual presence" in South Dakota.
  - Court variously referenced "targeted advertising," "instant access to most consumers through an internet-enabled device," a "virtual showroom," and a "continuous and pervasive virtual presence" as indicative of virtual contacts.
- For Internet sellers of reasonable size, arguing that the seller lacks "substantial nexus" is unlikely to succeed.

Commerce Clause Principles Revived

- Importantly, the Court ruled that "[t]he question remains whether some other principle in the Court's Commerce Clause doctrine might invalidate" state tax laws.
  - Court explained that "complex state tax systems" could discriminate against interstate commerce.
  - Court also found that "other aspects of the Court's Commerce Clause doctrine can protect against any undue burden" on interstate commerce.

Commerce Clause Principles Revived

- Previously, no issue of undue burden for state taxes existed outside of the physical presence standard, but the *Wayfair* Court clearly brought state tax laws under the umbrella of the dormant Commerce Clause.
- After *Wayfair*, states tax laws must now be evaluated to determine if they impose an undue burden on interstate commerce.
  - Relevant burdens are those imposed on "companies that do business in multiple states."
  - The "daunting complexity" of nationwide collection may pose "legitimate concerns," especially for small sellers.

Commerce Clause Principles Revived

- Court identified "several features" of South Dakota's tax system that "appear designed" to prevent "undue burdens on interstate commerce."
  - Economic thresholds that create a "safe harbor" for those who transact only limited business in the state;
  - Prohibition against retroactive liability; and
  - Membership in the Streamlined Sales and Use Tax Agreement (including significant simplification measures and software "paid for by the State").

Key Issues Left Unresolved

- How will economic presence thresholds be applied?
  - Must thresholds be adjusted based on state population or market size?
  - Are they measured based on gross sales or taxable sales?
  - When does the collection obligation kick in?
  - What constitutes a "transaction"?
- Will retailers be exposed to retroactive liability for pre-*Wayfair* tax periods?
  - Court found *Quill* "wrong when it was decided" and applied its new nexus standard to the retailers in *Wayfair*.
  - Majority did not focus on retroactivity, but strongly suggested it could raise constitutional concerns.
  - States that apply *Wayfair* retroactively against remote sellers are likely to be challenged.

Post-*Wayfair* Sales Tax Compliance

- It's a *Wayfair* world from here on:
  - Do not rely on a lack of physical presence (except as a factor), nexus is determined based on any contacts that evidence availing oneself of the privilege of doing business in a jurisdiction;
  - Sales and transactions thresholds are ascendant – more than 30 states now (or will soon) have them.
  - Retailers of all types should examine their obligations and be prepared to collect sales tax in additional jurisdictions.

POST-*WAYFAIR*
STATE ECONOMIC NEXUS
STANDARDS FOR SALES/USE TAX

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Post-*Wayfair* Economic Nexus: State Standards

- South Dakota Economic Nexus Thresholds
  - 24 states – CO, HI, IL, IN, IA, KY, LA, ME, MD, MI, NV, NC, ND, NE, NJ, RI, SC, SD, UT, VT, WA, WV, WI and WY
  - >$100K annual sales or 200 transactions
  - Prospective application only
  - All are SSTP except CO, HI, IL, LA, MD, ME, MD, SC
- Other Economic Nexus Thresholds
  - 8 states – AL, CT, GA, MA, MN, MS, OH, TN
- Marketplace Nexus
  - 9 states – WA, **PA, OK,** MN, NJ, CT, AL, IA, SD
  - Amazon collecting for all sellers in WA,PA,OK,MN,NJ,CT

(http://www.dillontaxconsulting.com/state-economic-nexus-standards?journal=76)

South Dakota-style Economic Nexus

- Rhode Island – enforced 8/17/17
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, any software transferred electronically or by load and leave, or taxable services
- Hawaii – enforced 7/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: tangible personal property, services or intangible property
- Kentucky – enforced 7/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: tangible personal property, digital property and taxable services

South Dakota-style Economic Nexus

- Vermont – enforced 7/1/18
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: tangible personal property
- Maine – enforced 7/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, any products transferred electronically, or taxable services
- Illinois – enforced 10/1/18
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: tangible personal property, excluding exempt sales

South Dakota-style Economic Nexus

- Indiana and Michigan – enforced 10/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, products transferred electronically or services
- Maryland – enforced 10/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, or taxable services
- New Jersey – enforced 11/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: tangible personal property, specified digital products or services

South Dakota-style Economic Nexus

- North Dakota – enforced 10/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: all sales, excluding nontaxable and exempt sales
- South Carolina – enforced 11/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross proceeds of all taxable retail sales, exempt retail sales, and wholesale sales of tangible personal property, inc. sales of property owned by another)
- Washington – enforced 10/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross retail sales (excludes resales)

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MEETING OBLIGATIONS, EXCEEDING EXPECTATIONS

South Dakota-style Economic Nexus

- Wisconsin – enforced 10/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of products & services
- Nevada – enforced 11/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: retail sales of tangible products
- North Carolina – enforced 11/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible/digital goods
- South Dakota – enforced 11/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, products transferred electronically or services

South Dakota-style Economic Nexus

- Colorado – enforced 12/1/18
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, products transferred electronically or services
- Iowa and Louisiana – enforced 1/1/19
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, products transferred electronically or services
- Nebraska – enforced 1/1/19
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of products and services

South Dakota-style Economic Nexus

- Utah – enforced 1/1/19
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, products transferred electronically or services
- West Virginia – 1/1/19
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross revenue from the sales of tangible personal property and services
- Wyoming – 2/1/19
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross revenue from the sales of tangible personal property, admissions and services

Other States' Economic Nexus

- Massachusetts – enforced 10/1/17
  - $500,000 AND 100 transactions
  - Threshold Measuring Period: Previous Calendar Year
  - Basis for Measuring Sales: all sales of tangible personal property or services, however consummated
- Ohio – (potentially) enforced 1/1/18
  - $500,000
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: taxable tangible personal property or services

Other States' Economic Nexus

- Mississippi – enforced 9/1/18
  - $250,000
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: total sales of product and services, including nontaxable and exempt sales
- Alabama – enforced 10/1/18
  - $250,000
  - Threshold Measuring Period: Previous Calendar Year
  - Basis for Measuring Sales: all sales of tangible personal property or services, however consummated
- Minnesota – enforced 10/1/18
  - $100,000 (10 or more sales) or 100 transactions
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: gross retail sales of tangible personal property (this excludes resales)

Other States' Economic Nexus

- Connecticut – enforced 12/1/18
  - $250,000 and 200 transactions
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: gross receipts
- Georgia – enforced 1/1/19
  - $250,000 or 200 transactions
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, delivered electronically or physically
- Tennessee – delayed
  - $500,000
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: gross sales

Marketplace Economic Nexus

- Intended to force marketplace facilitators to collect sales tax on all remote sales for all remote sellers
- Amazon collecting for all sellers: WA, PA, OK, MN, NJ, CT
- Etsy in WA, PA, OK and Ebay to begin in 2019
- Washington – enforced 1/1/18
  - $10,000 - $99,999
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross retail sales (excludes resales)
- Pennsylvania – enforced 4/1/18 (4/19 for digital)
  - $10,000
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: taxable sales of tangible property
  - by 9/15, Amazon to provide name, PA account number and sales for 2014-2016 to DOR

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MEETING OBLIGATIONS, EXCEEDING EXPECTATIONS

Marketplace Economic Nexus

- Oklahoma – enforced 7/1/18
  - $10,000
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: taxable merchandise
- Minnesota – enforced 10/1/18
  - $10,000
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross retail sales of tangible personal property (excludes resales)
- New Jersey – enforced 11/1/18
  - $1
  - Threshold Measuring Period: None
  - Basis for Measuring Sales: gross sales of tangible personal property, inc. products delivered electronically or services

Marketplace Economic Nexus

- Connecticut – enforced 12/1/18
  - $250,000 AND 200 transactions
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: gross receipts
- Alabama – enforced 1/1/19
  - $250,000
  - Threshold Measuring Period: Prior 12 months
  - Basis for Measuring Sales: tangible personal property
- Iowa (1/1/19), South Dakota (3/1/19)
  - $100,000 or 200 transactions
  - Threshold Measuring Period: Previous or Current Calendar Year
  - Basis for Measuring Sales: gross sales of tangible personal property, inc. products delivered electronically or services

Notice & Reporting Requirements

- 12 states with some or all requirements - CO, KY, LA, OK, PA, RI, SD, TN, VT, WA, GA, IA
  - Remote sellers whose sales exceed threshold (as low as $10K) must elect:
    1. Register, collect and remit despite no physical presence OR
    2. Notify buyers on website, at time of sale and annually, AND in many states notify taxing authority annually of all sales to all customers
  - All states impose economic nexus but some provide this option
- Severe penalties for non-compliance
  - PA – min. $20K
  - WA – $20K failure to post; $5K-$100K+ failure to report to customer and $20K+ failure to report to DOR

Post-*Wayfair* Economic Nexus: State Standards

- Does this Apply to All Sellers?
  - Yes – all remote sellers whose sales exceed the threshold must register, collect and remit sales tax on all taxable products and services
- Does this Apply Retroactively?
  - SD law does not, but Court did not require prospective only application of its decision. States may do so, however this is ripe with opportunity for challenge.
- Drop-shipments – if your drop-shipping supplier has nexus as a result of sales in these states, they may require a resale certificate, or may charge sales tax

Post-*Wayfair* Economic Nexus: State Standards

- This leaves 12 states that may have to address this legislatively, or administratively, prior to requiring remote sellers to collect sales tax on sales to customers in their jurisdiction
- Several states currently limit nexus to physical presence
  - However, MD did and this did not stop it from introducing emergency regulations adopting SD-style economic nexus
- Several states have broad, "catch-all" definitions for what constitutes "doing business" (i.e., having nexus) in the state (e.g., CA, TX)
  - Will they adopt regulations or issue a policy update?

Post-*Wayfair* Economic Nexus: State Standards

- Though physical presence is no longer the minimum threshold over which states may assert substantial nexus, it still creates nexus
- Many states have not changed laws
- Attributional nexus – agency, click-through, affiliate
- Growing trend that digital items may create physical presence
    - Cookie nexus – IA, MA, OH, RI
    - Data on server or network of servers
    - Licensed software used on customer computer

Post-*Wayfair* Economic Nexus: State Standards

Physical presence includes:

- Offices or tangible personal property
- Employees or Contractors – doing anything at all!
- Delivering goods in company vehicles
- Storing Inventory (Amazon FBA retailers)
- Regular, even Sporadic visits
- Trade Shows - Exhibiting / Orders, even Attending
- Data or space on a server **or** a network of servers
- Owning/licensing software to customer – TX (SaaS?)
- Virtual Presence – "cookie nexus" (MA)
- Attributional Nexus – agency and "affiliates"

Post-*Wayfair* Economic Nexus: State Standards

- Nexus Free For All? Patchwork of different standards and thresholds from state to state
- Heightened enforcement of existing nexus laws - Yes
- More economic nexus standards – double since *Wayfair*
- Potential for "virtual" nexus provisions (e.g., cookies)
- States begin taxing more services
- Retroactive Application of new nexus laws – not likely
- Lower thresholds – not likely, but WA, PA, OK
- Lawsuits challenging the constitutionality of state nexus provisions
- Congressional Action? Don't Hold Your Breath

WAYFAIR'S EFFECT ON OTHER TYPES OF STATE TAXES

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Taxes Other Than Sales Taxes and Property Taxes

- Income Taxes
- Gross Receipts Taxes
- Franchise Taxes
  - Taxes based on Income (CA)
  - Taxes Based on Paid In Capital (IL)/Net Worth (AL)
    - 13 states have such taxes

The *Wayfair* Effect: Physical Presence Is Not a Commerce Clause Requirement

- Effect One:
  - Removes the Commerce Clause Physical Presence requirement for all taxes
    - The Court confirmed the *Complete Auto* four part test applies to all state taxes
    - The Court reinterpreted the substantial nexus prong to make clear that physical presence is not required
    - First time that the U.S. Supreme Court ruled that physical presence not required for any tax

The Irony of *Wayfair*

- Prior to *Wayfair*, the states argued (and largely prevailed) that physical presence test of nexus only applied to sales taxes.
  - Income taxes: *Geoffrey v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993). *KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d 308 (Iowa 2010), *cert. denied*, 565 U.S. 817 (2011)
  - Gross Receipts taxes: *Crutchfield Corp. v. Testa,* 151 Oho St. 3d 278, 2016-Ohio-7760
  - Franchise and income taxes: *Capital One Auto Finance, Inc. v. OR Dept. Rev.*, 22 OTR 326 (2016), affirmed on other grounds 423 P.3d 80 (2018)

States: Because of *Wayfair* They Are Free to Impose Taxes Based on Sales Alone

- Effect Two: States and local jurisdictions have sought to impose taxes on companies without a physical presence in the Jurisdiction.
  - Portland Oregon referendum adopted on 11/6/18
    - 1% gross receipts tax on sales in Portland on a "large retailer," which is a retailer that: (1) is subject to the business license tax; (2) has more than $1 billion of sales and (3) has more than $500,000 of sales in Portland.
  - San Francisco referendum adopted on 11/6/18:
    - gross receipts tax on sales in San Francisco for all companies with more than $500,000 of SF gross receipts during the year

States: Because of *Wayfair* They Are Free to Impose Taxes Based on Sales Alone

- Does Registration to collect Sales Taxes Require Payment of Income Taxes and Franchise Taxes?
  - Kentucky and Oklahoma automatic response to register the companies for income tax.
- Should companies be reserving for potential income tax and franchise tax liability based on *Wayfair*?
  - Wells Fargo announcement of increase of its income tax reserves by $481 million as a result of *Wayfair*.

Will States Seek to Extend Wayfair Beyond Sales Taxes?

- By interpretation of broad doing business language in statute:
  - Franchise Tax on Paid In Capital or Net Worth
    - AL Stat Sec. 40-14A-22 on privilege of doing business
    - 805 ILCS 5/15.65 IL franchise tax on the privilege of exercising the authority to do business in the state
    - Oklahoma Tax Commission LR- 00 -37 (2000)
    - Holding of Oregon Tax Court in *Capital One* case
- By legislative enactment.

Limitations on a State's Power to Tax

- Limitations
  - Commerce Clause
    - Economic nexus standard: "Taxpayer 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."
    - Discrimination
    - Undue Burden-Retroactivity
  - Due Process Clause: requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."

Limitations on the States Power to Tax

- Other Limitations
  - Tax Must Be Authorized by Underlying State Statute
  - Public Law 86-272

State Tax Statute Must Authorize

- It is more common that the underlying statute limits the tax to those companies engaged in business activities in the states
  - Exceptions (MTC Factor presence states)(Sales alone constitute nexus):
    - Income Tax: Alabama; California; Colorado; Connecticut; Michigan; New York; Tennessee; and Virginia
    - Gross Receipts Tax: WA, OH, TN, and NV
    - Franchise Taxes: 13 states require payment of tax if "doing business in the state" or company obtains certificate of authority

Does *Wayfair* affect P.L. 86-272 protection?

- The short answer to the question is no.
  - Wayfair is a dormant commerce clause case that relates to the restrictions on a state power's to impose tax on interstate commerce in the absence of federal legislation.
  - P.L. 86-272 preempts state tax laws under the supremacy clause of the Constitution.

What protections are provided by P.L. 86-272?

- P.L. 86-272 provides that a state (or political subdivision) may not "impose . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person" are as follows:
  - the solicitation of orders in such State for sales of tangible personal property if orders are sent outside the state for approval and are fulfilled from outside of the State

What protections are provided by P.L. 86-272?

- Protected activities also include:
  - The maintenance in the state by an independent contractor of an office in the state so long as the independent contract is engaged in mere solicitation of the sale of tangible personal property.
    - An independent contractor is defined as an agent that does work for more than one principal.

What companies and activities are not protected by P.L. 86-272?

- Protection is not provided to companies incorporated in the taxing state.
- Protection is not provided for taxes other than taxes based on net income.
- The majority of commentators assert that the protection does not extend to companies that sell services, license intangibles or lease products. Richard Cram, "No Shade for Cloud Computing Income Under P.L. 86-272" *State Tax Notes*, Sept. 24, 2018

What companies and activities are not protected by P.L. 86-272?

- The presenter thinks that the majority opinion is wrong. See, Eisenstein and Bessey, Wayfair and P.L. 86-272 in a Services Economy, *State Tax Notes*, November 5, 2018
  - The protection in P.L. 86-272 is not limited to income derived from the sales of tangible personal property.
    - The reference regarding sales of tangible personal property relates only to the nature of in-state activities
  - Under the Supremacy Clause the intent of Congress is critical—the language of the statute is essential to determining intent.
  - The legislative history supports the presenter's minority view.

Does doing business on the Internet void the P.L. 86-272 protection?

- Wayfair concluded that the virtual contacts with a state of an Internet site and economic contacts created nexus.
- Some have argued that such virtual and economic contacts are activities in the state that exceed the P.L. 86-272 protection.
  - PL 86-272 sets the lower limit of a state's power to tax. *Heublein Inc. v. SC Tax Commission*, 409 U.S. 275 (1972)
  - Standard under the Commerce Clause is not same under P.L. 86-272 because different basis for limitations on state powers. See Eisenstein and Bessey article

Income Tax: *Wayfair's* Effect on the *Joyce* and *Finnigan* Tests

- *Joyce* and *Finnigan* are references to two different ways of calculating a unitary group's sales factor numerator in a combined or consolidated return.
- Under *Joyce* (18 states), only the sales of a corporation with nexus will be included in the numerator of the sales factor.
- Under *Finnigan* (17 states), if any company of the group has nexus the sales of all companies will be included in numerator.
- Effect of *Wayfair*: If company is not protected by P.L. 86-272, then more states to be included in sales numerator of destination state.

Income Tax: *Wayfair's* Effect on the Throwback/Throwout Rules

- 25 states have a throwback rule, which provides that sales to a state without nexus are included in the home state's numerator.
- Two states have throwout rules (NJ and WV): provide that any sales to a state where the company is not obligated to pay the income tax are removed from both the numerator and denominator.

Wayfair's Effect on Tax Planning for Other Taxes

- Highlights the importance of good tax planning
  - Make sure that P.L. 86-272 limits are not exceeded.
    - Consider guidelines
  - Make sure that company as a matter of course does not register to do business in another state.
    - Could give rise to franchise tax liability as a concession that company is doing business. See Louisiana Private Letter Ruling No. 08-007 (certificate of authority to do business)
  - Multistate planning involving diluting sales in high tax states.

IMPLEMENTATION OF SALES TAX COMPLIANCE POST-*WAYFAIR*

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Implementing Sales Tax Compliance Post-*Wayfair*

WARNING

- REMEMBER: Physical Presence still creates nexus – inventory (FBA), attributional (click-through, affiliate) AND this applies to ALL sellers, inc. SaaS, services

- DO NOT simply register in states once you determine you have nexus without taking several additional steps prior thereto

Implementing Sales Tax Compliance Post-*Wayfair*

- Determine Nexus
  - Review historical sales ($ and #) by state
  - Review state economic nexus standards
  - Review physical presence nexus creating activities
- Develop sales tax decision matrix
  - Establish sales and use tax compliance process
  - Determine taxability of products and services - tax table containing taxability determinations relating to the company's sales and purchases, which can then be automated.
  - Determine whether you must obtain resale / exemption certificates for exempt sales
  - Process to monitor taxable purchases (select accounts, problem vendors, materiality) to ensure vendors are properly charging sales tax or that you accrue / remit use tax

Implementing Sales Tax Compliance Post-*Wayfair*

- More detailed, tax-centric descriptions in contracts and invoices reduce audit exposure
- Decide whether to register where nexus exists or risk of nexus is material
  - You may practically decide that registration and the cost of compliance outweighs the risk of exposure if your average sale is $15 and you exceed economic nexus 200 transaction threshold
  - 200 x $15 = $3,000
  - $3,000 in sales at 8% tax rate is $240 per year
- Mitigate any historical exposure proactively (VDAs)
  - Benefits include limited lookback, penalty waiver, payment plans and control of audit

Implementing Sales Tax Compliance Post-*Wayfair*

- Implementing sales tax compliance software
  - Compliance – rating each transaction and Return preparation
- Requirements
  - Systems must address who, what, when, where, hows
  - Map each tax decision and tax category code to
    - customer profile – who? are they exempt? do we have cert?
    - product code – what is being sold?
    - invoice date and title/possession transfer – when? shipping terms (FOB Origin v. FOB Destination) and timing of event
    - jurisdiction – where? ship to, service delivery/performance
    - how being delivered – electronic
- What systems are available
  - Avalara, Vertex, Taxware, BillSoft, EZTax
  - TaxJar and Taxify for e-commerce platforms

Implementing Sales Tax Compliance Post-*Wayfair*

- Implementing exemption certificate management
  - Create, validate, store, manage certificates
  - Integrate with ERP, accounting, tax decision and POS systems
  - Automation Tools –
    - Avalara CertCapture, Vertex ECM, ONESOURCE TCM
    - Can implement "home grown" platform into ERP, scan and manage certs and interface with billing and tax systems
- Register to file sales and use taxes - consider impact on other tax obligations
- Provide / obtain appropriate resale certificates, particularly on drop-shipment transactions
- Monitor and maintain

MONITORING BUSINESS/ACTIVITIES FOR SALES TAX COMPLIANCE AND MINIMIZING UNEXPECTED LIABILITY GOING FORWARD

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Do Not Delay

- If your business has not already analyzed the impact of *Wayfair* on potential state tax obligations, begin promptly.
  - Additional potential liability may be accruing;
  - A congressional solution is unlikely.
- Companies doing business in multiple states will almost certainly have expanded state tax obligations as a result of *Wayfair*.
- Retailers should move to implement a system for registration, collection and remittance in multiple states.

Understand The Rules

- Federal Constitutional Standard
  - Company “avails itself of the substantial privilege of doing business in the jurisdiction.”
  - May be established by:
    - Economic contacts
    - Virtual contacts
    - Physical presence

Understand The Rules

- State-Specific Standards
  - Sales thresholds:
    - Amount (e.g., $100,000 or 200 transactions)
    - Measure (e.g., gross vs. taxable; TPP, services, digital goods, etc.)
    - Timeframe (calendar year, rolling 12-mo. or 4-qtrs.)
    - Once crossed, when must collection commence?
  - Other tests or factors:
    - In-state activities
    - "Regular or systematic solicitation"

Understand The Rules

- Determine whether the nature of your business exposes you to state tax obligations in each state.
  - State law definitions of "retailer" / "vendor" / "dealer" and of "retail sale":
    - Sellers of tangible goods typically satisfy definitions.
    - Providers of services may not (e.g., financial services).
    - Categorization not always straightforward.
  - Income, franchise, and gross receipts taxes may have broader reach.

Understand The Rules

- Be aware of the significance of sourcing.
  - Know where a sale will potentially be subject to tax -- may be determined by, among other factors:
    - Delivery location(s);
    - Place(s) of first use;
    - Where the "benefit" is received;
    - Where services are performed;
    - Business or billing address(es).
  - Understand possible differences for other types of tax.
  - Structure contracts and sales documents accordingly.

Thoughtfully Implement Expanded Compliance

- Build a defense: document your compliance challenges and responses:
  - Due diligence: Memorialize your efforts in achieving compliance.
  - Hardship: Make a record of specific compliance challenges of your business.
  - Be ready to defend an audit or assessment later by what you do now.
- Undertake registration carefully to avoid pitfalls.

Track Your Sales and Business Activities

- State-by-State (for appropriate time periods):
  - Sales *and* transactions (latter often triggered first).
  - By category:
    - Tangible personal property, services, digital goods, etc.
    - Gross, taxable, and non-taxable/exempt;
  - In-state activities:
    - Employees and representatives, travel, inventory, etc.
    - Be intentional – have guidelines and follow them.
    - Note -*Wayfair* may free-up the company!
  - Other factors (e.g., deriving receipts from licensing of IP.)

Track Your Sales and Business Activities

- Implement mechanisms to:
  - Signal when sales or other activities exceed identified thresholds; or
  - Review tracking data periodically (monthly) for each state where the business is potentially subject to tax.
- Ensure sales tax compliance system allows for readily "turning on" sales tax compliance and registering with additional jurisdictions.
- Follow-through in a timely manner.

Keep Watching For New Developments

- *Wayfair* fallout has really just started.
  - 12 states have still made no formal announcement, including many of the largest states (CA, NY, FL, PA, OH, VA, etc.);
  - "Home rule" localities have yet to announce sales tax enforcement positions;
  - State and localities have provided minimal guidance on other types of taxes apart from sales/use.
- Companies should work with their tax advisors to stay current on legal requirements.

WAYFAIR'S IMPACT ON SPECIFIC TYPES OF SELLERS AND ON MARKETPLACES

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Categories of Possible Sellers

- Internet Sellers of Products
- Non-Internet Sellers of Goods
- Sellers of Digital Products
- Providers of IT Services
- Companies Located Outside of the United States
- Marketplaces

Key Features of the New Test

- No bright line but case-by-case approach
- Substantial Nexus: "Taxpayer 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."
    - Common carrier deliveries count:
        - $100,000 of goods/200 separate transactions
        - Large companies with extensive virtual presence:
            - Cookies and apps

“Some Other Principle”

- Discrimination: In-state retailers vs. interstate sellers
- Undue Burden: The “*Wayfair* Factors”
  - Size of company and magnitude of sales
  - Retroactivity of the state’s law
  - SSUTA

“Some Other Principle”

- SSUTA
  - Single state level administration
  - Uniform definitions of products and services
  - Simplified tax structures
  - Provides free software
  - Immunity from Liability

Internet Sellers: Substantial Nexus

- Substantial Nexus Questions
  - Is it a relative test by population of state?
  - If sales transactions exceed the threshold but sales are below the dollar amount, is that substantial? Vice versa?
  - Does the nature of the delivery into the state affect substantial nexus?
    - Company owned trucks? Contract carriers? White glove service?

Internet Sellers of Products: Discrimination

- Turns on state laws and not kind of company
- Prime example of possible discrimination: Origin sourcing states

Internet Sellers of Products: Undue Burden

- Is there a weighing of the capabilities of the companies vs. the nature of the state's laws?
  - Size of company has some relevance
- Member of SSUTA vs. not a member.
- Single state rate?
- Compensation to retailers for collection?

Non-Internet Sellers of Products

- Types:
  - Pure mail order catalog company
  - Inserts in magazines and newspapers
  - Television advertising
- Does the type of promotion affect the test?
  - Substantial nexus? Is virtual presence different?
  - Undue burden?

Sellers of Digital Products

- Substantial Nexus:
  - No deliveries to the state, such as in *Wayfair*
  - Is the virtual presence of digital products in a state doing business in the state?
- Undue Burden:
  - How does seller learn the buyer's address?
- Discrimination: Sourcing because of place of delivery

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Sellers of Digital Products

- PL 86-272
  - *Wayfair* test does not apply, because enacted per Commerce Clause affirmative grant of authority (the power "to regulate Commerce … among the several States.") *Wayfair*, 138 S.Ct. at 2089(federal legislation controls)
  - Are digital products deemed TPP? *See AccuZIP Inc. v. Director, Division of Taxation*, 25 N.J. Tax 158, 171 (N.J. Tax Court 2009)

Sellers of Digital Products: Due Process Question

- Does a sale of products delivered digitally have "some definite link, some minimum connection between a state and the person . . .." *Wayfair*, 138 S.Ct. at 2093, quoting *Miller Brothers*
- Does the digital transmission of products constitute sufficient contacts with the state? It is "defendant's contacts with the forum state itself, not the defendant's contacts with the persons who reside there," that create the minimum contacts. *Walden v. Fiore*, 134 S. Ct. 1115, 1122 (2014)

Providers of Services

- Similar factors under Substantial Nexus/Undue Burden/Discrimination/Due Process tests, except that:
  - Fewer if any connections to the state where the buyer benefits from the services or from which the buyer accesses the service and the seller.
    - E.g. Cloud Services
    - E.g. Help desk
  - May be service activities in state; e.g. installation

Providers of Services

- Is there a different test under PL 86-272 for services?
  - See discussion on prior slides

International Sellers

- Two additional elements to the *Complete Auto* test:
  - Is there a substantial risk of international multiple taxation; i.e. does the foreign country impose a transactional tax?
  - Does the tax prevent the federal government from speaking with one voice; i.e. treaty commitments
- Is an assessment enforceable outside of the U.S.?

Marketplace Facilitators

- CT, IA, MN, NJ, SC and WA require marketplace facilitators whose sales by marketplace sellers exceed a certain threshold to collect and remit the sales tax on such sales
- OK, PA and RI give the marketplace facilitator the option to collect or comply with notice and reporting.
- Marketplace Facilitator: (1) facilitates a retail sale by an advertisement for the retailer and (2) collects payment for the retailer.

Marketplace Facilitators

- Is there a difference in the analysis?
  - A marketplace facilitator has added burden and costs of determining the taxability of products across many sellers
  - A marketplace facilitator does not benefit from in-state deliveries, as do retailers
  - Is a marketplace facilitator different than a bricks and mortar shopping center?