The Wayfair Ruling's Impact on Financial Reporting

Daniel Sanders, Partner | DHG Professional Standards Group

In arguably the most important sales tax case in the past twenty-five years, the U.S. Supreme Court released its highly anticipated decision in *South Dakota v. Wayfair, Inc.* in June. In essence, the *Wayfair* decision eliminated the historical "physical presence" nexus standard for sales tax and effectively puts into place an "economic" nexus standard based on the amount of business a company does in a given jurisdiction. The court upheld South Dakota's nexus statute, which defines doing business in the state as having greater than $100K in sales or 200 transactions in a year within the state.

The Court's decision in *Wayfair* will have a significant impact on businesses across many industries that sell products or services in multiple states. Not only are online retail businesses affected by this ruling, but many other companies that are remote sellers of goods and services could be impacted, such as manufacturing, distribution, construction, software, healthcare, professional services and many others

Impact on Financial Reporting

Much of the current focus regarding the *Wayfair* decision concerns states that have enacted similar nexus statutes or regulations like that of the South Dakota law. The effective date of states' sales and/or transaction-based sales & use tax nexus standards and their related thresholds vary from state to state, with some states enacting more aggressive statutes than others. To date, over thirty states have announced some form of economic nexus and we anticipate that most, if not all, of the remaining states will address economic nexus in their 2019 legislative sessions. Therefore, it is important that companies evaluate each state's reaction to *Wayfair* along with the relevant accounting guidance around the implications of the *Wayfair* decision.

When certainty exists that an entity will be subject to a liability for sales & use tax in particular jurisdictions due to *Wayfair*, a liability should be recognized in accordance with ASC 405, *Liabilities*, and measured based on the applicable laws. The liability would then represent a contractual obligation rather than a loss contingency.

Sales & use taxes are not within the scope of ASC 740, *Income Taxes*. Therefore, when uncertainty exists as to whether an entity will be subject to a liability for sales & use tax due to *Wayfair*, ASC 450, *Contingencies*, should be evaluated. Estimated losses from a loss contingency are accrued if it is probable that a liability has been incurred as of the date of the financial statements, and the amount of loss can be reasonably estimated. A liability should be recognized if (1) the entity concludes that it is probable that the entity should have charged sales tax based on the taxability and nexus standard of the state where they are selling and (2) the amount can be reasonably estimated. The liability would then be measured based on applicable laws. Even if an accrual is not made for a loss contingency, but it is at least reasonably possible that a loss or an additional loss has been incurred, then certain disclosures would be considered regarding the contingency.

Considerations

Companies should consider whether changes to internal controls, systems, or processes are needed to comply with new sales & use tax requirements and the related financial reporting implications; such considerations can help mitigate potential administrative burdens within a long term scenario.

DHG will continue to monitor the impact of this landmark case as states continue to implement changes to their laws and regulations. If you have any questions or would like additional information about the decision and its other potential impacts, please contact your advisor, or the contacts listed below.

DHG Contact

Daniel Sanders
Partner, DHG Professional Standards Group
assurance@dhg.com

Tommy Varnell
Senior Manager, DHG tax
tax@dhg.com