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***Wayfair's* Impact on States' View of Nexus & Potential Sales Tax Burden on Technology Companies**

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Welcome from the Technology Association of Georgia

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  - Learn More: https://www.tagonline.org/

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Agenda

- Nexus Background and the *Wayfair* Decision
- State Reactions to the *Wayfair* Decision and Other Nexus Standards
- Thinking About the Implication of Economic Nexus
- Income / Franchise / Business Activity Tax Implications

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Nexus Background and the *Wayfair* Decision

Background: Sales Tax Nexus Before Wayfair

- **A state's right to tax governed by U.S. constitutional limitations**
  - Commerce Clause
  - Due Process Clause
- **A state tax will be sustained so long as it:**
  - **Applies to an activity with a substantial nexus to the taxing state;**
  - Is fairly apportioned;
  - Does not discriminate against interstate commerce; and
  - Is fairly related to the services the State provides
    - *Complete Auto Transit, Inc.* (1977)

What constitutes "substantial nexus"?

Historically, for the imposition of sales tax, substantial nexus required **physical presence**

- *National Bellas Hess, Inc. (1967)*
- *Quill Corp., v. North Dakota (1992)*

What is Physical Presence?

- **While there is some variance among states' interpretation of physical presence, it typically includes:**
  - Property
  - Employees
  - Inventory
  - Contractors / agents
  - Temporary visits to a state
  - Delivery vehicles entering state
  - Some states include:
    - Affiliate entities
    - Click-through Nexus

Challenges to Physical Presence

From a vendor standpoint, physical presence has become less representative of the activity taking place in each state.

Why?
- Emergence of e-commerce
  - Customers buy online from vendor instead of brick and mortar store
    - In many cases, vendor is out-of-state and not registered to collect sales tax.
- Shift to service-based / intangible economy
  - Rather than buying software on a disk, customers download or remotely access software

- The changes in our economy have led to several challenges to the physical presence nexus standard over the last 20 years.
- *Direct Marketing Association v. Brohl* (2015) started us down this path with Notice and Reporting Requirements being upheld in Colorado.
- However, until *Wayfair, Quill* continued to be the law of the land regarding sales tax collection and remittance.

Polling Question #1

Over the past several years, has your business noticed an increase in nexus questionnaires from states where you are not registered?

a) Yes
b) No
c) Not sure. Fortunately, that task doesn't fall on me.

Wayfair vs. South Dakota (2018)

The Decision…
- Court ruled 5-4 in favor of South Dakota.
- Decision overturns physical presence requirement of *National Bellas Hess* and *Quill.*
- Court focused on whether activity could establish "substantial nexus" as outlined in *Complete Auto Transit* without having physical presence.

What South Dakota Statute Did *Wayfair* Uphold?

The Supreme Court in *Wayfair* upheld a South Dakota statute:

- In reviewing the South Dakota statute the Supreme Court observed, the statute:
  - Had a safe harbor for small business;
    - Only have to register if more than $100,000 in sales or 200 transactions annually
  - Was not retroactive; and
  - South Dakota conformed (is a member) of the streamline sales tax agreement
    - State administered tax
    - Uniform definitions of products and services

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State Reactions to the *Wayfair* Decision and Other Nexus Standards

Economic Nexus States

States assert nexus for remote sellers with no physical presence:

- Must exceed sales threshold
  - Generally $100k to $250K but some states have enacted lower thresholds
- Minimum number of transactions (e.g., 200 separate transactions)
  - Some states only have a sales threshold
- For states that have both thresholds, it is typically “either / or”, not “and”

Polling Question #2

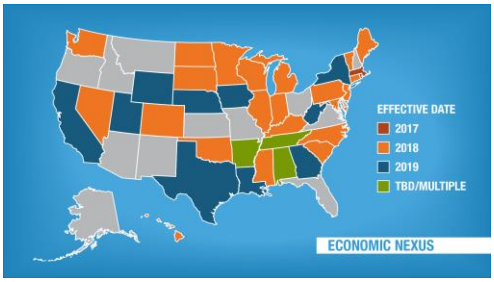
For the states that have the either / or thresholds, which is more concerning for your business?

a) Revenue per state ($100K, for example).
b) Number of transactions per state (200, for example).
c) Both, depending on the state.
d) Neither, we are already filing everywhere.

State Reactions to *Wayfair*

- **To date, more than 35 states have enacted or announced some form of economic nexus.**
  - Most had effective dates between October 2018 and January 2019.
  - In many cases, states are relying upon existing laws / regulations.
- **A reasonable period to register and start collecting.**
- **Home Rules States: AL, CO and LA:**
  - Alabama has adopted a simplified sellers use tax rule, allowing remote sellers to collect a single 8% rate.
  - Colorado will enforce economic nexus for state and any local taxes that are administered by the state. Other local jurisdictions may have own thresholds.
  - Louisiana, similar to Alabama, will allow remote sellers to apply to file Direct Marketer Sales Tax Return. This has a single 8.45% rate and covers all state and local jurisdictions in LA.

State Map – Economic Nexus Summary



Source: www.dhg.com/wayfair

Watch Out for Differences Among States

While many states have adopted similar approach as South Dakota, there can still be differences in their approaches, including:

- Thresholds – Does state leverage SD thresholds or something else?
- Effective date of economic nexus
- Definition of sales for purposes of defining revenue threshold
  - Retail, taxable, gross sales, etc.
- Measurement period – how often must a taxpayer lookback to see if they exceeded economic nexus threshold?
- Traditional state sales tax differences (even pre-*Wayfair*)
  - Rates, taxability of products and services, filing frequencies

Other Approaches Beyond Economic Nexus

Before and during *Wayfair*, states have been developing other approaches to increase remote seller compliance, including:

- Notice and reporting requirements
- Assertion of nexus based on marketplace provider presence
  - In most cases, this provides relief for the remote seller, as states are going after the marketplace providers to collect tax.
- Cookie nexus
  - Software and apps create physical presence

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Thinking About the Implication of Economic Nexus on Technology Companies

What are the overall impacts of *Wayfair*?

Area	Before Wayfair	After Wayfair
Nexus Studies	Focus on physical presence, including property, employees and agents in each state.	Evaluate economic activity in each state, including sales and number of transactions. Even if under these thresholds, physical presence should be considered.
Exemption Certificates	At a minimum, collect certificates in states where there is a physical presence.	Consider collecting certificates in all jurisdictions. Even if below economic threshold for registration currently, with thresholds being so low in most states, slight changes in sales can change future filing requirements.
Taxability Determinations	Focus on states where there is a filing requirement.	Evaluate taxability in all states due to lower threshold for registration and potential need to apply tax in additional states.
Registration Requirements	Based on physical presence and in some cases, type of business or sales being made into each state.	Based on sales volume in many states, $100K in sales or 200 transactions in a year for example. States may differ in how they define "sales" for purposes of meeting economic threshold – could be gross sales, retail sales or taxable sales.
Risk and Exposure Analysis	Focus on physical presence footprint, taxable sales and exemption documentation within this footprint.	Much more complex. Look at sales across the U.S., layering in each states economic threshold and effective dates while still considering physical presence.
Booking Reserves (ASC 405 / 450)	Do liabilities exist or do contingencies rise to the level of probable and estimable?	With many more jurisdictions in play for most companies, much more likely that a liability or contingency could exist.

What are the overall impacts of *Wayfair*? (cont'd)

Area	Before Wayfair	After Wayfair
Purchase / Use Tax Activity	Vendors would charge tax if they were registered in a purchaser's state (typically triggered by vendor's physical presence).	Expect more vendors to start collecting tax based on the expansion of their nexus footprint. Evaluate the need to extend exemption certificates or turn off use tax accruals.
Drop Shipments	In many states, drop shippers can accept out-of-state resale certificates from companies that don't have nexus in their customer's state.	With nexus expanding, higher likelihood that company selling product has nexus in customer's state and will not be able to extend an out-of-state certificate. Companies selling products through drop shippers may create a filing requirement in many additional states.
Impact on Mergers and Acquisitions	Identifying non-compliance in some jurisdictions during due diligence is typical, but usually limited to a few jurisdictions and can be immaterial.	Expect non-compliance to expand as states enact changes more rapidly than companies are able to react. When evaluating exposure, pre and post-Wayfair periods should be analyzed separately if no physical presence exists.
Other Tax Filings	With some exceptions, most state taxes follow similar physical presence standards as sales tax.	If a company registers for sales tax due to economic nexus in a state, evaluate other state taxes to see if additional filings may be necessary. If nothing else, registering for sales tax will increase a state's awareness of activity taking place within that state.

What About Technology Companies?

In addition to the overall implications, there are areas that may be more impactful to IT companies.

- Sourcing
  - Particularly for vendors providing digital goods, SaaS, SW licensing or electronically downloaded software to users across multiple states
    - Is vendor properly capturing location of their client's users?
    - For states with users where SW vendor is not registered, does *Wayfair* now change that?
- Taxability
  - Software and IT related services are some of the most complex areas among states when it comes to categorization and taxability.
  - Pre-*Wayfair*, companies are focused on states with physical presence. Now must focus on sourcing and taxability among many more states.

What About Technology Companies? (cont'd)

- **Contract / Invoice Impacts**
  - Do customer agreements properly allow for IT company to capture location of customer's users, particularly with customers that have multi-state users?
- **Systems**
  - Are systems in place to capture and apply tax where appropriate across the U.S.?
- **Compliance**
  - Are processes in place to handle expanded compliance burden?

Polling Question #3

What is the biggest concern for your business in addressing the impact of *Wayfair*?

a) Exposure building for states with early enforcement dates while our business is still getting our arms around the issues.
b) Having the systems in place to handle taxability and rate calculations for increased number of jurisdictions.
c) Having enough resources to address the higher volume of compliance going forward.

Summary of Sales Tax Implications

Wayfair has added another level to the nexus standard for sales tax

- It does not replace the physical presence standard. Even if under economic thresholds within a state, physical presence may still trigger filing requirement.
- Most states have or soon will adopt economic nexus standards for sales tax.
- Expect this to expand to most, if not all states that administer a sales tax in the near future.

Expanded requirements will demand more resources, potential need for more sophisticate sales tax systems and increased burden on compliance.

For more information and updates, please visit: www.dhg.com/wayfair

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Income / Franchise / Business Activity Tax Implications

Economic / Factor Presence Nexus

- Economic / Factor Presence Nexus
- Constitutional Considerations – do they exist after *Wayfair?*
  - Historic Ohio Cases including *L.L. Bean, NewEgg, etc.*
- Public Law 86-272 – still applicable?

Factor Presence States

Jurisdiction	Nexus Standard	Enacted
MultiState Tax Commission	$50,000 property OR $50,000 payroll OR $500,000 sales (25% rule)	2002
Alabama	$50,000 property OR $50,000 payroll OR $500,000 sales (25% rule)	2015
California	$58,387 property OR $58,387 payroll OR $583,867 sales (25% rule)	2011
Colorado	$50,000 property OR $50,000 payroll OR $500,000 sales (25% rule)	2010
Connecticut	$500,000 in Connecticut sales	2010
Michigan	$350,000 in Michigan sales	2012
New York	$1,000,000 in New York sales	2015
Ohio	$50,000 property OR $50,000 payroll OR $500,000 sales (25% rule)	2005
Tennessee	$50,000 property OR $50,000 payroll OR $500,000 sales (25% rule)	2016
Virginia	Any positive factor creates nexus	****
Washington	$285,000 in Washington sales	2010
Philadelphia	$100,000 in Philadelphia sales	2019
San Francisco	$500,000 in San Francisco sales	2019

Apportionment / Revenue Sourcing

- Revenue sourcing is no longer solely an apportionment issue.
- Understanding revenue by state is now critical in determining nexus.
- Simple and vague market sourcing rules are being replaced with very detailed, cascading rules.
- Without thoroughly investigating all possible revenue sourcing positions, taxpayers could unknowingly have nexus in a jurisdiction.

MTC Model Regulations – Services / Intangibles

- Cascading set of rules that look to:
  - Location of service delivery / receipt**
  - Reasonable approximation
  - Safe harbor provisions
  - Throwout provisions

*** In the case of electronic transmission, where the service is received is intended to reflect the location at which the service is directly used by the employees or designees of the customer.*

Polling Question #4

What approach does your business take to source revenue for income tax purposes?

a) A thorough review of each states' statutes and regulations.
b) Customer's billing address.
c) Whatever comes out of the computer.

Summary of Implications

- *Wayfair* has given states increased confidence in economic / factor presence standards.
- Expect the trend of factor presence standards for income / franchise / business activity taxes to continue.
- This trend will also further stimulate the trend towards market sourcing as well as potentially single sales factor, combined reporting, etc.
- Public Law 86-272 not realistic for as many taxpayers as in the past.

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Questions?

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