Wayfair and the Impact on Manufacturers and Distributors

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With the vast changes in sales tax requirements among states due to the impact of Wayfair, manufacturers and distributors should consider how this will apply to them. The summary below discusses how this could impact businesses throughout the U.S. Some of the issues most applicable to the manufacturing and distribution industry include:

- Sales to customers in other states, even if sales are made for resale / wholesale. In some states, even making wholesale sales will trigger economic nexus.
- Collection of exemption certificates from customers buying for resale, as this should now be evaluated for all states, not just the states where the manufacturer or distributor has physical presence.
- Purchases from out-of-state vendors who may now have nexus in the manufacturer's or distributor's state and turn on sales tax, whether or not it should be.
- Drop shipments made on behalf of third parties and the documentation that may be deemed acceptable by states, as the third parties may now have nexus and be required to provide certificate from ship-to state.

Background

In 2016, South Dakota passed a law stating that an out-of-state vendor with no physical presence in the state must register for South Dakota sales tax if the vendor has 200 transactions or more into the state or their annual sales into the state exceeds $100,000. In addition to passing the law, South Dakota also sued several large e-commerce vendors that they felt exceeded these thresholds, including Wayfair, Overstock.com and Newegg. The issue ultimately landed in the U.S. Supreme Court (*South Dakota v. Wayfair, Inc.*).

In June 2018, the Supreme Court's 5-4 decision in *Wayfair* ruled in favor of South Dakota. The ruling upheld the state's requirement that certain retailers, with no physical presence in South Dakota, collect sales taxes from in-state customers and held that South Dakota's law was not a burden on interstate commerce and was not overreaching.

What are other states doing?

With South Dakota prevailing in *Wayfair*, many other states have enacted similar economic nexus laws or regulations. The South Dakota statute sets a minimum threshold of $100,000 in sales or 200 or more separate transactions of tangible property, products transferred electronically, or services delivered within the state annually. Since the *Wayfair* decision, there has been a swift adoption of similar economic nexus laws in other states. To date, more than 35 states have enacted or announced some form of economic nexus, most with effective dates ranging between October, 2018 and January, 2019.

A summary of state economic nexus adoption dates and thresholds can be found on our website at dhg.com/wayfair.

What should taxpayers do now?

In light of *Wayfair* and the impact that this will cause to the way states administer sales and use tax, the following table summarizes some of the primary areas that should be evaluated by these changes.

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 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 made into each state.	Based on sales volume in many states, $100K in sales or 200 or more 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 450)	Does anything within risk and exposure rise to the level of probable and estimable?	With many more jurisdictions in play for most companies, much more likely that a liability could exist.
Purchase / Use Tax Activity	Vendors would charge tax if they were registered in a purchaser's state (typically triggered by 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 a 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.

Summary

Wayfair has changed the landscape of nexus standards for sales tax, with most states already announcing prospective adoption of economic nexus standards. Expanded compliance requirements will demand more resources, a potential need for a more sophisticated sales tax system and perhaps greater outsourcing of compliance.

We will continue to provide updates and perspective on the impact of this landmark case as states begin to implement changes. If you have any questions or would like additional information about the decision and how it may affect your business, please contact your DHG advisor or a DHG State and Local Tax Professional.

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