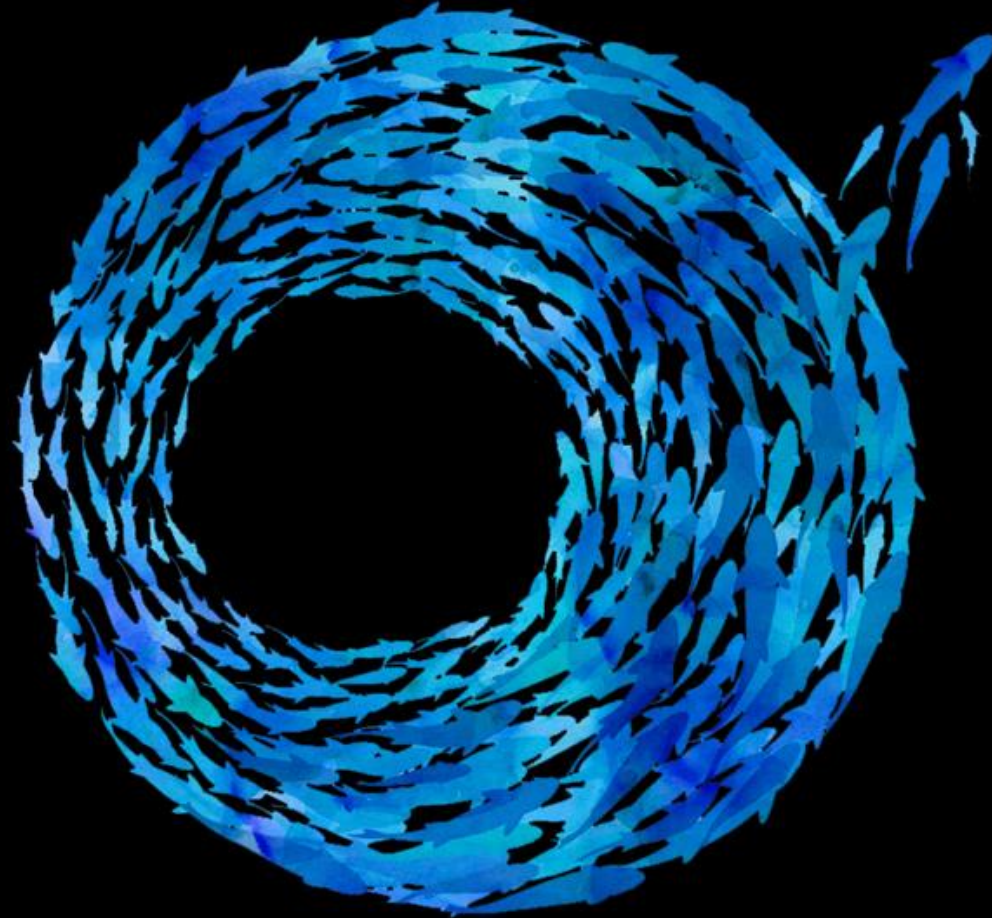


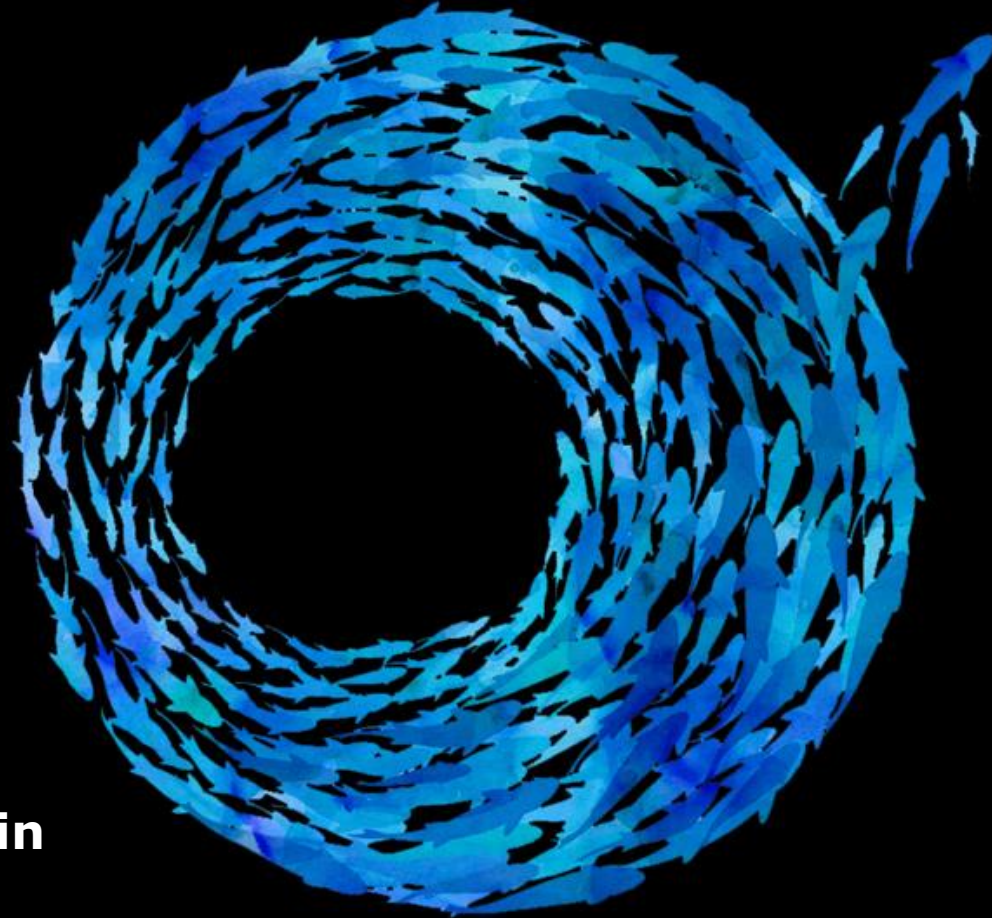
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**The 2018 National  
Multistate Tax Symposium**

Take the lead—Tax reform and fortifying state positions

February 7-9, 2018



**Indirect taxes – Hot topics in  
the digital economy**

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# Agenda

- Introduction
- Nexus – The Wild, Wild West
- Online marketplaces – The New Frontier
- Sourcing & taxability – The madness continues
- The Internet of Things – What's next
- Conclusion: Q&A

# **Nexus – The Wild, Wild West**

## Expanding physical presence

States have been passing nexus laws requiring tax collection and filing responsibilities that **push the boundaries** of the concept of “physical presence”

- **“Click-through nexus”** - Compensated solicitation/referral arrangements
  - e.g., AR, CA, CT, GA, IL, KS, LA, ME, MI, MN, MO, NV, NJ, NY, NC, OH, PA, RI, TN, VT, WA
- **Affiliate nexus** – Corporate affiliates
  - e.g., AL, AR, CA, CO, FL, GA, IL, IA, KS, LA, ME, MI, MO, NV, NY, OH, OK, PA, RI, SD, TX, UT, VA, WI, WV
- **Notification and/or reporting** – Information reporting requirements
  - e.g., AL, CO, KY, LA, OK, RI, SC, SD, VT, WA
- **Economic nexus** - aka “kill-Quill”
  - e.g., AL, IN, ME, MA, ND, OH, RI, SD, TN, VT, WA, WY

## “Click-through” nexus

- New York State enacted the first “click-through” nexus statute in 2008
- Seller is **presumed** to have nexus through an **independent contractor** or representative if the seller enters into an agreement with a **resident** where the resident:
  - For a **commission or other consideration**
  - **Directly or indirectly** refers potential customers to the seller
  - Whether by a **link on an internet website or otherwise**
  - If the cumulative gross receipts from sales from residents with this type of an agreement **exceeds \$10,000** in the preceding four quarters

## Rebutting the “click-through” presumption

- New York published guidance on **rebutting the presumption** in TSB-M-08(3.1)S (Jun. 30, 2008). The seller may rebut the presumption by meeting two conditions.
- **Contract condition** – The contract prohibits “engaging in **any solicitation activities**...that refer potential customers to the seller including, but not limited to: distributing flyers, coupons, newsletters and other printed promotional materials, or electronic equivalents; verbal solicitation (e.g., in-person referrals); initiating telephone calls; and **sending e-mails**. In addition, if the resident representative is an organization such as a club or a non-profit group, the contract or agreement must provide that the organization will maintain on its Web site information alerting its members to the prohibition against each of the solicitation activities described above; and”
  - **Proof of compliance condition** – The resident must submit a **signed certification** that the resident representative has not engaged in any prohibited solicitation activities.

## Affiliate nexus

- Nexus for out-of-state entity based on relationships with one or more **related parties** (affiliates) in the state or on activities affiliates may perform on behalf of the remote retailer
- Affiliate statutes generally, but not always, look to the activities performed by an in-state affiliate which help related entities to establish and **maintain a market** in that state
- Examples include
  - Use of common logos and **trademarks**
  - In-state **distribution centers** from which delivery occurs
  - In-state affiliate's **promotion** of the out-of-state affiliate's goods or services
  - **Allowing returns** of goods purchased online at the in-state affiliate



## Affiliate nexus – Example

- Pursuant to Fla. Stat. Ann. § 212.0596(2)(k), “[e]very dealer ... who makes a mail order sale is subject to the power of this state to levy and collect the tax imposed ... when:
- The dealer, while **not having nexus** with this state on any of the bases described in paragraphs (a)-(j) or paragraph (l), is a corporation that is a **member of an affiliated group** of corporations, as defined in s. 1504(a) of the Internal Revenue Code, whose members are includable under s. 1504(b) of the Internal Revenue Code and whose members are eligible to file a consolidated tax return for federal corporate income tax purposes and **any parent or subsidiary corporation in the affiliated group has nexus with this state** on one or more of the bases described in paragraphs (a)-(j) or paragraph (l)”

## Notification and reporting

-In order to “encourage” remote retailers to “voluntarily” collect tax, many states have passed **notification and reporting** statutes which require:

- **Notification** - These rules require a retailer to notify buyers that use tax may apply
- **Reports to Buyers** - Send an annual report to buyers listing items purchased
- **Reports to State** - Send an annual report to the state with each buyer’s activity

-Colorado’s statute was challenged and after a lengthy process was ultimately upheld with SCOTUS denying cert - *Direct Marketing Assoc’n v. Brohl*, 135 S. Ct. 1124, 1131 (2015)

-Other states have adopted or are **considering notification and reporting statutes**

-The MTC has drafted a **model statute** for notification and reporting that is currently under review.

## Economic nexus: Kennedy concurrence - *Direct Marketing Ass'n v. Brohl*

- In *Direct Marketing Assoc'n v. Brohl*, 135 S. Ct. 1124, 1131 (2015), Justice Kennedy made statements in his concurrence indicating *Quill* is **ripe for reconsideration** and could possibly be overturned:
  - “Given...changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court’s holding in *Quill*. A case **questionable even when decided**, *Quill* now harms States to a degree far greater than could have been anticipated earlier.”
  - “The instant case does not raise this issue in a manner appropriate for the Court to address it. It does provide, however, the means to note the importance of **reconsidering doubtful authority**. The legal system should find an appropriate case for this court to reexamine *Quill* and *Bellas Hess*.”

Recent Alabama promulgation along with South Dakota and Vermont legislation establishing **sales-based nexus threshold** for sales tax collection arguably appear to be responses to Justice Kennedy’s remarks.

## Economic nexus - South Dakota

- On March 22, 2016, Senate Bill 106 (S.B. 106) was signed into law. S.B. 106 amends Codified Laws § 10-45 and 10-52, **effective May 1, 2016**, to require the collection of South Dakota sales tax on sales into South Dakota if, in the previous or current calendar year:
  1. The seller's sales into South Dakota **exceed \$100,000**, or
  2. The seller **had two hundred or more separate transactions** into South Dakota.
- S.B. 106 provided the authority for South Dakota to bring a declaratory judgment action in order to **expedite the determination** as the validity of this nexus standard under state and federal law. S.B. 106 also provided an **injunction provision** to enjoin enforcement of the law pending the declaratory judgment action.

## Economic nexus - South Dakota (cont'd)

- April 2016: State and online retailers filed **declaratory judgments** in Circuit Court.
- March 2017: Circuit Court **struck down remote sales tax law**; DOR appealed, setting the stage for review by the state supreme court.
- September 2017: South Dakota Supreme Court affirmed the Circuit Court ruling, holding that this law was unconstitutional in **violation of the physical presence requirement** under *Quill*.
- October 2017: South Dakota **filed cert** with the U.S. Supreme Court—specifically asking whether the Court should “abrogate *Quill*’s sales-tax-only physical-presence requirement.”
- The parties’ briefs and **21 amicus curiae briefs** have been filed
- On January 12, 2018, the U.S. Supreme Court agreed to hear this case.
- An **injunction is currently in place** that prevents the state from enforcing the law while the constitutionality is challenged

# Online marketplaces – The New Frontier

# Online marketplaces

## Traditional buy/sell model

- The merchant **purchases products** and/or services from various sources.
- The merchant then **resells** the products and/or services to end users or other brokers.
- The **merchant is responsible** for any taxes related to its activity.

## Marketplace model

- Third-party merchants list products for sale on **marketplace's platform**.
- Buyers shop on the marketplace.
- Marketplace **manage checkout** and in some cases **process payments**.
- Some online marketplaces also offer products for sale. Others only serve as a marketplace for third-party sellers.
- Fees vary:
  - Sell fee – Seller pays a **fee to list** and/or upon a **successful sale**
  - Buy fee – Buyer pays a fee to the marketplace to **join and/or purchase** items

## Online marketplaces

- Merchants and marketplaces must determine the following:
    - Who is the marketplace's customer?
    - Who is the seller of the goods or services sold on the marketplace?
    - Who is required to collect tax?
    - Are the goods or services listed on the marketplace subject to sales and use tax?
    - Is the service fee received from the buyer or seller subject to sales and use tax?
    - Do the agreements, invoicing, or other reporting documentation properly describe the arrangement?
    - Are there any system considerations that impact the collection of tax?
- The states have generally not provided guidance on **who is responsible** for tax for goods and services sold through a marketplace



## Online marketplaces

- States are considering and some have passed “marketplace/referrer responsibility” legislation imposing **notice and reporting** or **collection and remittance** obligations on marketplaces
  - **Minnesota**, New Mexico, New York, North Carolina, **Pennsylvania**, **Rhode Island**, Texas, and **Washington**
- A **Multistate Tax Commission** work group is looking at defining “marketplace facilitator” in its draft model for state sales and use tax reporting and notice statutes
- South Carolina assessed an online seller \$12.5M on all third-party sales for Q1-2016 using a **consignment store** argument
- In Massachusetts, a judge ordered an online seller to give the state **information about merchants** who stored goods in the state over the past six years.
- An MTC work group is looking at defining “**marketplace facilitator**” in its draft model notification and reporting statutes

# Sourcing & taxability – The madness continues

## SSTP Section 310: General Sourcing Rules

A. Except as provided in Section 310.1, the retail sale, excluding lease or rental, of a product shall be sourced as follows:

1. When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.
2. When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.
3. When subsections (A)(1) and (A)(2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.
4. When subsections (A)(1), (A)(2), and (A)(3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.
5. When none of the previous rules of subsections (A)(1), (A)(2), (A)(3), or (A)(4) apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).

# Washington WAC 458-20-15503 Digital Products Sourcing

This rule provides a structured approach for determining tax liability for digital products and digital codes. For purposes of this rule, a digital product includes digital goods or digital automated services, which are described in detail below. The sale or use of digital products and digital codes is generally subject to retail sales or use tax unless purchased for resale or some other exemption applies.

This rule is organized into six parts. Each part addresses a question or topic relevant to the determination of whether a person is selling or purchasing a digital product or digital code and, if so, what are the tax consequences that follow from such activity. In this respect this rule is intended to function similar to the decision tree provided in ETA 9003.2010.

Part 1: Are the products or services transferred electronically? If yes, go to Part 2.

Part 2: Does the product or service meet the general definitions of digital product or digital code? If yes, go to Part 3.

Part 3: Are there applicable exclusions from the general definitions of the digital product or digital code? If no, go to Part 4.

Part 4: Are the sales of the digital product or digital code sourced to Washington? If yes, go to Part 5.

Part 5: Are there applicable retail sales or use tax exemptions for the purchase or use of the digital product or digital code? If no, the transaction is likely taxable in Washington.

Part 6: Miscellaneous provisions.

# Tax sourcing ramifications

- **Tangible personal property**

- Generally destination
- Consider subsequent use
- Consider concurrent use (prewritten computer software)

- **Services & digital goods**

- Varies by state. May be based upon the location of:
  - Benefit received or destination
  - Performance
- Consider multi-state benefit – MPU Certificate

- **Software**

- Server location: The location of the server upon which the software is residing
- Benefit: The location where the benefit of the service is derived. Typically this is where services are being utilized.
- Destination/bill to address: The location where the invoice is sent
- Multiple points of use: Software and services are “apportioned” to multiple states

# What are “cloud” based services? Are they taxable?

## **-Tax ramifications driven by -**

- How the product/ service is defined
- How the product/ service is delivered

## **-What are you selling/buying?**

- Tangible personal property
- Software
- Service
- Digital Good
- Some or all of the above
- Something else

## **-How is it being delivered?**

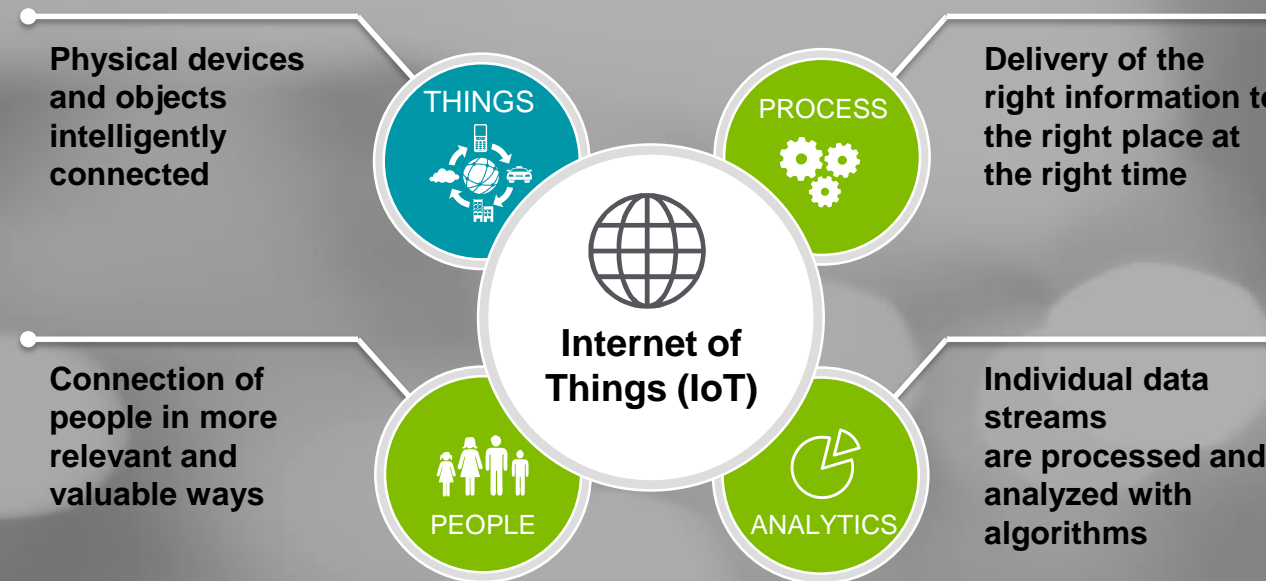
- Tangible form
- Electronically delivered
- Electronically accessed
- Electronically streamed

- Where will the services be used or consumed?
- Are there users in multiple states?
- Should a Multiple Point of Use exemption form or Direct Pay permit be used?

# The Internet of Things – What's next

# Making sense of the buzzwords: What is the Internet of Things?

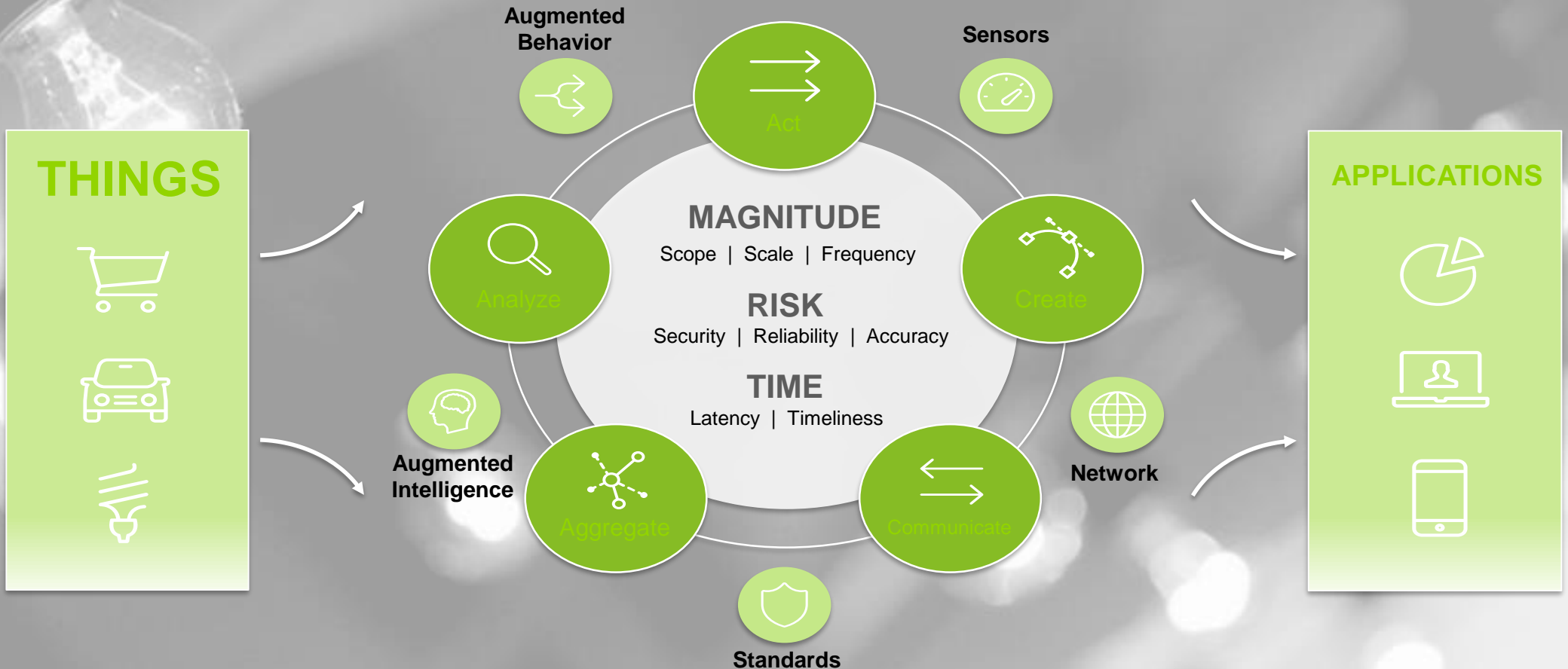
Internet of Things (IoT) refers to a world of intelligent, connected devices that generate data for automating business processes and enabling new services





# Information value loop

This is a framework for thinking about IoT solutions and is based on recognition that value lies in the DATA generated by sensors and connected devices



# Which industries does it impact...



## MANUFACTURING

- Predictive Maintenance
- Supply Chain Optimization
- Asset Tracking
- Automate Workflows
- Personnel Safety



## ENERGY & RESOURCES

- Smart Grid
- Leakage Prevention
- Wellhead Optimization
- Asset Optimization
- Personnel Safety



## RETAIL / CONSUMER PRODUCTS

- Consumer Marketing
- Reimagined Store Front
- Intelligent Replenishment
- Supply Chain Management
- Memorable Experiences



## LIFE SCIENCES / HEALTHCARE

- Clinical Trials
- Patient Experience
- Equipment Tracking & Diagnostics
- Remote Monitoring
- Inventory Management
- Supply Chain Management



## AUTO / TRANSPORTATION

- Dealership of the future
- Remote diagnostics
- Fleet management
- Autonomous vehicle



## MILITARY

- Connected battlefield
- Supply chain
- Fleet Tracking



## FINANCIAL SERVICES

- Perf-based Insurance
- Personalized risk profiles
- Retail banking



## SMART CITIES

- Smart lighting
- Transportation / Energy Management
- Smart parking
- Smart waste

# Consumers are benefitting from IoT right now

IoT can make life easier, more convenient, and more enjoyable



## What does it mean?

IoT and tectonic shifts in technology lead to a real redefining of company boundaries:

- New business models
- New products
- New partners, ventures, relationships
- New customers
- New competitors
- New markets
- New industry implications/concerns
- Unclear/undefined marketplace
- Faster change in product mix, focus, strategic direction



## Transaction taxation – What is being sold?

Jurisdictions could characterize into any of the following taxable categories:

- Enumerated service ("cloud" or Application Service Providers)
- Sale, rental, or access to prewritten software
- Data processing
- Data storage service
- "Digital automated service"
- Computer service, computer exchange service
- "Canned" information service, "personalized" information service
- Communications service
- Digital equivalent to traditional tangible personal property 'aka' digital goods

**Not only important to define what it is not, but must also be able to identify what it is!!!**

## M2M & telematics

Taxpayer v. Commissioner, Court of Appeals of Tennessee, No. M2006-01398, 2007 (9/26/2007)

- A service allowing commercial trucking companies to locate and determine the status of individual vehicles as well as communicate with its drivers was not subject to Tennessee sales and use tax. Telecommunication was not the true object or primary purpose of the service.

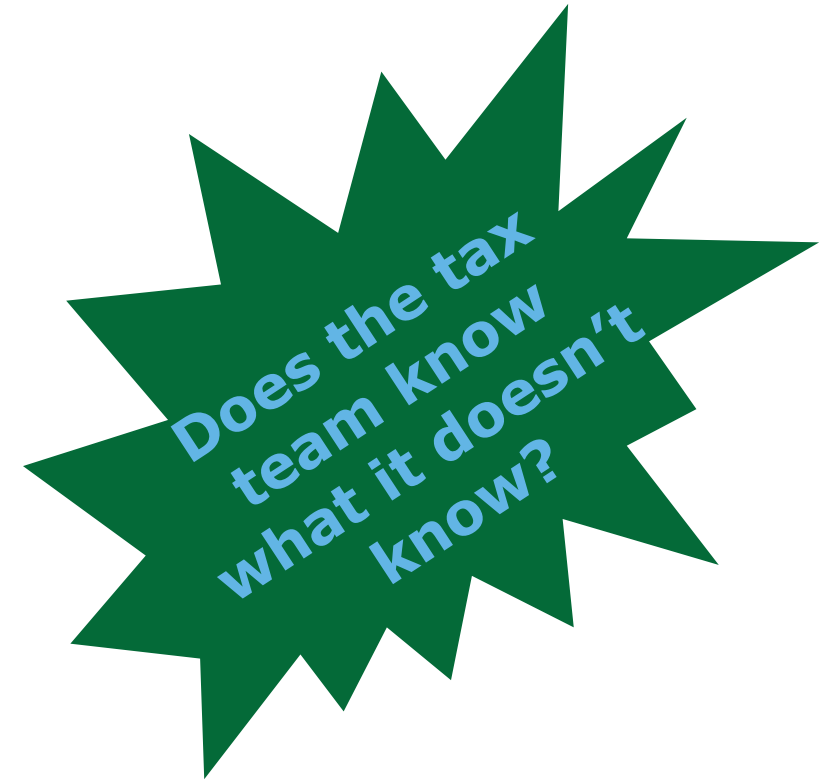
Taxpayer v. DOR, Washington Supreme Court, No. 83673-6, 171 Wash.2d 125 (3/10/2011)

- The Supreme Court reversed the Court of Appeals, which had held that the truck tracking service was taxable as "network telephone service," and therefore subject to retail sales tax. The court determined that the primary purpose of the purchasers of the truck tracking service was to obtain the data generated by the system.

## Various taxation areas to contemplate

New industry sector tax regime in the core specialization of tax team

- Nexus, PE, (e.g. Marketplace Fairness Act)
- Indirect tax (Sale/Use, VAT, GST) and withholding
- Apportionment, sourcing of income
- Intellectual property migration
- Transfer pricing
- Incentives and R&D
- Global mobility and global benefits planning



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