The 2019 National Multistate Tax Symposium
State tax reboot—The age of Multistate

February 6-8, 2019
The path forward for sales and use tax reporting

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Nexus Post Wayfair
What are US sales-and-use tax nexus creating activities?

<table>
<thead>
<tr>
<th>Pre-Wayfair Rules: Physical Presence</th>
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<tr>
<td>US State sales and use tax nexus was not based upon Permanent Establishment (PE) principles or treaties. Previously, nexus could be created in various ways:</td>
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<tr>
<td>• In-state employees &amp; independent contractors</td>
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<td>• Sporadic employee/independent contractor visits</td>
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<td>• Attending trade shows and seminars</td>
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<td>• In-state deliveries made by one’s own truck</td>
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<td>• Physical presence of property even temporality</td>
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<td>• Incidental ownership of property</td>
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<td>• Voluntary registration or incorporation</td>
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<tr>
<th>Pushing the Edges of Physical Presence</th>
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<tr>
<td>States wanted to change ‘physical presence standard’ and started to pursue remote sellers in various ways:</td>
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<td>• Affiliate or agency nexus; volunteers, agents, independent contractors</td>
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<td>• Click-through nexus (e.g. NY)</td>
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<td>• Internet nexus through “cookie” or electronic nexus presence</td>
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<td>• Marketplace provider platforms nexus</td>
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<tr>
<td>• Notification and reporting statutes for remote sellers with steep penalties for non-compliance (e.g. CO)</td>
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Wayfair US Supreme Court decision on nexus—South Dakota law in question

On March 22, 2016, Governor Dennis Daugaard signed Senate Bill 106 (S.B. 106) amending S.D. 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:

- The seller’s sales into South Dakota higher than $100,000, or
- The seller had two hundred or more separate transactions into South Dakota.
Wayfair US Supreme Court decision—Substantial nexus does not require physical presence

• Court overruled Quill (1992) and National Bellas Hess (1967) finding the physical presence rule promulgated under these decisions was “unsound and incorrect.”

• The Court rendered a 5–4 decision –
  − Justices Kennedy, Ginsburg and Alito, with Justices Gorsuch and Thomas concurring; and Chief Justice Roberts with Justices Breyer, Sotomayor, and Kagan dissenting.

• The main reasons the court found for overturning Quill -
  − The application of a physical presence requirement is an “incorrect interpretation of the Commerce Clause” particularly when measured in a vastly expanded e-commerce marketplace.
  − South Dakota’s law does not violate substantial nexus requirements because remote sellers have the potential to maintain a significant virtual presence in the state.
  − The principle of stare decisis cannot stand when it prohibits states from exercising lawful powers.
Wayfair US Supreme Court decision—Consideration given to other Commerce Clause measures

• Considering the other elements of the Complete Auto test for the validity of a state tax, the Court noted that the South Dakota law has “several features that appear designed to prevent discrimination against or undue burdens to interstate commerce.”
  − $100,000 in sales or 200 transaction threshold may be sufficient, but does not establish a minimum necessary to satisfy substantial nexus.
  − High thresholds mean only applies to retailers doing considerable amount of business in state.
  − Not retroactive.
  − Streamlined sales and use tax agreement system’s ability to alleviate some burden.
Federal Efforts with respect to remote sales tax collection

Federal Legislation - Remote Sales Tax Collection in the 115th Congress -

- House & Senate – Pre-Wayfair
  - H.R. 2887 - No Regulation without Representation Act – Sponsors: Reps. Sensenbrenner, Goodlatte

- House & Senate – Post-Wayfair
  - S. 3180 - Stop Taxing Our Potential Act – Sponsor: Sen. Tester

Outlook for Federal Legislation in the 116th Congress -

- With Democratic takeover of the House, chances appear to be slim that any type of federal legislation limiting the application of the Wayfair decision will move forward.
National & State Efforts with respect to remote sales tax collection

**NCSL Post-Wayfair Principles**

- States should consider waiting until 1/1/19 to begin sales tax collection requirements for remote sellers (**19 States** require collection prior to 1/1/19)
- Only about half the states are SST Members – none of the “big” states; no new states in recent years.
- Simplify registration – one stop shop and use CSP that will register, file etc.
- Encouraging states to join SST process – website - [www.streamlinedsalesestax.org](http://www.streamlinedsalesestax.org)

**State Action Regarding Implementation**

- **11 States** – adopted de minimis thresholds and retroactive bans like South Dakota and are also SSUTA member states – GA, IN, IA, KY, MN, NJ, ND, SD, UT, VT & WY
- **12 States** – are SSUTA member states, but need additional legislative action to address de minimis thresholds and retroactivity bans – AR, KS, MI, NE, NV, NC, OH, OK, RI, WA, WV & WI
- **18 States and DC** – have not taken steps to sufficiently simplify sales taxes generally (CA, CT, FL, HI, ID, IL, ME, MD, MA, MS, MO, NM, NY, PA, SC, TN, TX & VA)
- **4 States** – Need substantial simplifications addressed due to local taxes (AL, AZ, CO & LA)
- **5 States** – Do not have sales taxes (AK–does have local sales taxes, DE, MT, NH & OR)
National & State Efforts with respect to remote sales tax collection

What are the issues companies need to consider post-Wayfair -

• If you may have previously set up a separate company to possibly avoid any requirement to collect sales taxes, what should you consider doing now if you have other entities that are filling in the states?

• Should these separate entities be collapsed to eliminate multiple filings in a given jurisdiction?

• What are the non-sales tax ramifications of collapsing any prior separate entities?

• In SST States – sellers should review how they can benefit from Certified Service Providers (CSPs) to manage taxability and tax rate tables in those states.

Other issues that need to be considered in light of the Wayfair decision -

• Real-time sales tax adoption – goal was to accelerate payments by 3rd party payment processors. How would this burden be viewed if imposed on remote sellers?

• Qui-tam and class-action litigation for sales tax collections. Both may impose risk to sellers.

• The issue many will continue to analyze – the potential impact this new standard has on other entity-based taxes imposed in the states that remote sellers are now required to register and collect/remit sales taxes.
Use Tax Notification and Reporting Statutes
Information Reporting—“Use” Tax Approaches

• **Colorado model**
  - 2012 statute requires “non-collecting” retailers to inform customers and state that they may have a use tax obligation for taxable purchases.
  - The law specified that any out-of-state retailer that does not collect the sales tax on taxable purchases that has gross revenues in excess of $100,000 in the state.
    ◦ To send a transactional notice to the customer that they may be subject to the state’s use tax.
    ◦ Send a detailed annual purchase summary to customers that purchase more than $500 of goods during the year, reminding them of potential use tax obligations.
    ◦ File the annual customer information report with the DOR.

• **Penalties**
  - Penalties for failing to comply and report vary between states, but are generally high and punitive.

Ultimately upheld as constitutional when the U.S. Supreme Court denied certiorari in *DMA* case.

How will these requirements interact with the new requirements for sellers to collect/remit sales taxes post-*Wayfair*?
## Use Tax Notification Requirements & Reporting

(As of September 30, 2018)

<table>
<thead>
<tr>
<th>State</th>
<th>Effective Date</th>
<th>Threshold</th>
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<tbody>
<tr>
<td>Alabama</td>
<td>7/1/2017</td>
<td>$250,000</td>
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<tr>
<td>Colorado</td>
<td>7/1/2017</td>
<td>$100,000</td>
</tr>
<tr>
<td>Connecticut*</td>
<td>7/1/2017</td>
<td>N/A</td>
</tr>
<tr>
<td>Georgia</td>
<td>1/1/2019</td>
<td>$250,000 or 200 transactions</td>
</tr>
<tr>
<td>Iowa</td>
<td>7/1/2019</td>
<td>$100,000</td>
</tr>
<tr>
<td>Kentucky</td>
<td>7/1/2013</td>
<td>$100,000</td>
</tr>
<tr>
<td>Louisiana</td>
<td>7/1/2017</td>
<td>$100,000</td>
</tr>
<tr>
<td>Oklahoma**</td>
<td>6/9/2010, 11/1/2016 &amp; 4/10/2018</td>
<td>$100,000/$10,000</td>
</tr>
<tr>
<td>Pennsylvania***</td>
<td>4/1/2018 &amp; 4/1/2019</td>
<td>$10,000</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>8/17/2017</td>
<td>None</td>
</tr>
<tr>
<td>South Dakota</td>
<td>7/1/2011</td>
<td>$100,000</td>
</tr>
<tr>
<td>Vermont</td>
<td>7/1/2017</td>
<td>$100,000</td>
</tr>
<tr>
<td>Washington (retail sales)</td>
<td>1/1/2018</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

*The Connecticut Department of Revenue Services began mailing notices to several unregistered online retailers demanding electronic sales records for all individual sales made to customers with Connecticut addresses over the past 3 years. On July 7, 2017, Governor Daniel Malloy signed Public Act No. 17-147 into law, which gives the Commissioner authority to impose a civil penalty of $500 per day for failing to comply with these type of information requests, effective July 1, 2017.

**Oklahoma has had three different use tax notification requirement statutes. The first had a $100,000 threshold. The most recent version has a threshold of $10,000.

***Pennsylvania effective date of 4/1/18 applies to sales of products and services other than digital products and services. Effective date of 4/1/2019 applies to sales of digital products and relates services.

The above list of states that have currently enacted use tax notice and/or reporting provisions based on the existence of a certain amount of in-state sales and/or transactions is intended for informational purposes only. Taxpayers should consult with their tax advisors as to each state’s effective date and other requirements relative to their specific business activity and potential penalties for non-compliance.
Inbound Tax Considerations
Inbound company tax considerations

**Are non-U.S. sellers any different?**

- Levy of sales/use tax in South Dakota is determined based on the location of the purchaser, without regard to where the sale originated. As such, the *Wayfair* decision upholding the South Dakota law may impact foreign companies with US sales.
- States generally are not bound by treaty protections, and bilateral tax treaties generally do not otherwise apply to non-income taxes at the state & local level.
- The seller’s presence or lack of Permanent Establishment (PE) does not determine whether there is nexus or ability to apply a penalty relating to use tax reporting.
- Foreign Commerce Clause?
- Difficulty of state enforcement.

**Compare with Value Added Tax ("VAT")**

- Permanent Establishment or
- Registration Threshold (similar to economic nexus thresholds).
Evaluating A Company’s Position and Potential Exposure
Overview of ASC 450 – *When Recognizing a Liability is Appropriate*

When a loss contingency such as the uncertain incurrence of a transaction tax liability exists, the likelihood that the future event or events will confirm the incurrence of the liability can range from probable to remote:

- **Probable**: The future event or events are likely to occur (higher level of likelihood than more likely than not contained in ASC 740).
- **Reasonably possible**: The chance of the future event or events occurring is more than remote, but less than likely.
- **Remote**: The chance of the future event or events occurring is slight.
ASC 450 considerations – Wayfair Decision

**Financial reporting analysis is necessary on a state-by-state basis**

- Companies should revisit positions they may have taken for sales and use tax collection purposes regarding the need for physical presence to establish substantial nexus.

- While the facts at issue in *Wayfair* involved a statute with prospective application, potential retroactive application and enforcement to the effective date of a state’s applicable statute remains uncertain.

**Notification and reporting statutes**

- Approximately ten states have enacted notification statutes which can carry substantial penalties.

- Such states require remote sellers to provide in-state buyers with information regarding their use tax obligations, as well as to provide a report to the state detailing in-state purchases.
Key steps to begin your implementation evaluation

<table>
<thead>
<tr>
<th>Nexus</th>
<th>Taxability</th>
<th>Automation</th>
<th>Sourcing</th>
<th>Compliance Readiness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Understand historic and future nexus implications</td>
<td>Determine how states may tax the company's products or services</td>
<td>Perform a system's readiness assessment</td>
<td>Collect and verify information needed to source sales</td>
<td>Evaluate internal resources available to comply in new states</td>
</tr>
<tr>
<td>Determine in which states the company is not currently collecting and remitting</td>
<td>• If the company is selling tangible personal property, presumption is the sale is taxable unless an exemption or exclusion applies</td>
<td>• Evaluate current financial systems and associated capabilities</td>
<td>• Analyze whether shipping address, place of receipt, and delivered-from location are available</td>
<td>• Will state compliance administrative burden increase with new filing requirements</td>
</tr>
<tr>
<td>Understand past, present, and future activities that may establish physical presence</td>
<td>• If the company sells services, including software or electronically delivered services, a characterization analysis may be necessary</td>
<td>• Analyze current sales and use tax reporting software, if available</td>
<td>• Determine whether full address information, including zip code plus 4, is available when no shipping address is needed</td>
<td>• Evaluate the availability of internal resources to file monthly, quarterly, or annual returns based on each state's assigned filing frequency</td>
</tr>
<tr>
<td>Evaluate state's current economic nexus thresholds and effective dates</td>
<td>• In order to properly characterize products, customer agreements, marketing materials, and delivery models should be analyzed</td>
<td>• If no tax collection software is available, analyze potential providers</td>
<td>• Evaluate whether third party vendors (e.g., payment processors, marketplace facilitators) provide necessary sales detail to support sourcing position?</td>
<td>• Evaluate the cost and benefits of outsourcing returns versus using internal resources</td>
</tr>
<tr>
<td>Determine a nexus creation date, if any, for each state where the company is not currently registered and remitting sales and use tax</td>
<td>• Evaluate exemptions or exclusions that may apply to the product</td>
<td>• Determine whether systems are able to report and reconcile returns to financial data</td>
<td>• Determine whether automated analytics and dashboards can drive efficiencies within the tax compliance and reporting process</td>
<td>• Evaluate exemption certificate collection processes to ensure proper collection, when applicable</td>
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<tr>
<td>• If a state's statute or guidance is not clear, the company may consider requesting a ruling from the state</td>
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- Evaluate internal resources available to comply in new states

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Online Marketplaces and Direct Online Sales
Emerging Business Models

Online Marketplaces

• New business model where the marketplace provider allows a virtual space that brings buyer and seller together in order to facilitate a sale

• The states have generally not provided significant guidance
  – Handful of states considered “online marketplace provider” legislation in last several years - imposing collection obligations on companies offering online platforms on which third-party retailers sell their products
  – As of October 1, 2018, AL, CT, IA, MN, NJ, OK, PA, RI, and WA have enacted online marketplace provider laws
  – A Multistate Tax Commission Wayfair Implementation and Marketplace Facilitator Work Group is meeting monthly to discuss and develop concepts or ideas related to marketplace facilitator collection requirements

• Taxpayers must determine the following
  – Who is the marketplace’s customer?
  – Who is the seller of the product or service sold on the marketplace required to collect tax?
  – Is the product or service 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 address these issues?
  – Are there any system considerations that limit collection of tax?
Other Emerging Issues and Trends to consider -

• States continue their efforts to expand their sales tax base to include certain forms of digital commerce
  − Most proposals have been focused on digital downloads – specifically video delivery and provision of software
  − States are still struggling with how to impose taxes on “service” forms of similar commerce (streaming video and cloud-based access to software, i.e. SaaS) – lines of delineation are not always clear
  − Some measures sought to expand the tax base, while others sought to specifically exclude certain digital products from taxation
  − Legislative proposals advanced in GA, IA, IN, KS, OK, RI, VA, WV in 2018
  − Only passed in IA

• Issues that continue to be a concern that will need to be addressed as states move forward –
  − Sourcing – hard for determining situs for digital downloads, even harder for streaming and cloud-based services
  − Clear delineation of goods and services that are included in the tax base
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