

A black and white photograph of a person in a business suit holding a magnifying glass over a folder. The person's hand is visible, holding the handle of the magnifying glass. The folder is open, showing several white pages. The background is dark.

# *Wayfair* Two-Year Update

July 29, 2020

# Note

1. This presentation is intended to make participants aware of tax issues that may apply to this audience.
2. Information presented herein is not intended to be tax advice.
3. Please consult with a qualified practitioner for tax advice related to specific transactions.

# Speakers



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# Agenda



- Historical Context & Current Status
- Enforcement
- Post Wayfair Compliance
- Exposure Mitigation
- Unintended Consequences
- Looking Forward

A grayscale photograph of the United States Capitol dome in the background, with an American flag waving in the foreground. The image is partially obscured by a green horizontal bar.

# Historical Context & Current Status

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## Nexus

- Minimum connection with state in order to be subject to their tax laws

## Case History

- National Bellas Hess, Inc. v. Dept. of Revenue of Ill., 386 U.S. 753 (1967)
  - Established physical presence standard
  - Burden of requiring vendors to collect and remit sales tax without physical presence too much of an impediment on interstate commerce
- Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 285 (1977)
  - Tax will not violate Commerce Clause if:
    1. Applied to an activity with a substantial nexus with the taxing state
    2. Fairly apportioned
    3. Does not discriminate against interstate commerce
    4. Fairly related to the services provided by the State

# Historical Context & Current Status

## Case History - cont'd

- Quill Corp. v. North Dakota, 504 U.S. 298 (1992)
  - Applied Complete Auto test and determined that “substantial nexus” meant physical presence
- South Dakota v. Wayfair, Inc., 585 U.S. \_\_\_\_\_ (2018)
  - In 2016, South Dakota enacted an economic nexus standard, directly contradicting Quill’s “physical presence” rule
    - \$100,000 in gross revenue or 200 transactions per year
  - Online retailers with no physical presence in South Dakota challenged the constitutionality of the nexus standard
  - The U.S. Supreme Court reversed its holding in Quill, abandoning the physical presence standard for sales nexus
  - The Court reasoned that the physical presence test:
    - Arbitrarily created competitive advantages for out-of-state retailers
    - No longer makes sense in light of technological advancements and the modern economic realities of internet retailing

# Historical Context & Current Status

## Current Status

- Majority (43 states plus DC and AK localities) enforcing some form of economic nexus on sales tax
- Many states have implemented economic nexus post Wayfair decision
- Others relying on previously existing statutes
- Trends
  - Retroactivity – Trend is toward prospective enforcement
  - Movement away from transactional thresholds
  - Use tax notification requirements
  - Movement away from physical presence – Does economic nexus truly replace the physical presence test?
- Adjustment of nexus thresholds since initial legislation





# *Wayfair* Enforcement

# Wayfair Enforcement

## State Enforcement

- General Information Letters / Technical Memoranda
  - Administrative notice informing taxpayers of nexus thresholds and filing requirements
  - May provide information on registration and/or voluntary compliance
- Nexus Questionnaires
  - Provided directly to specific taxpayers
  - Use caution when completing
  - Non-response may trigger an audit or further inquiry
- Desk Audits
- Lookback Period
  - Economic nexus is prospective in majority of states
  - Measurement period for transaction/gross receipts thresholds
    - Current or prior calendar year
    - Trailing twelve months
    - “Expected” to reach threshold

# Wayfair Enforcement

## Local Enforcement

- Home Rule Localities
  - Localities administer their own taxes (examples: Parishes in LA and Cities in CO)
  - State administered localities vs. true home rule (self-administered)
  - Significantly increases number of jurisdictions for compliance
  - Rules may differ between state vs. local jurisdictions
  - Contrary to spirit of Wayfair decision
  - Very little guidance issued to date
  - Does the state threshold apply to individual localities?
- State vs. local registrations are a key factor
- Taxpayer must assess risk of not registering with locals

# Wayfair Enforcement

## Local Enforcement - cont'd

- Some states with home rule localities have achieved simplification
  - AL – statewide rate of 8% for remote sellers
  - LA – statewide rates of 8.45% for remote sellers has been replaced as of July 1, 2020; Remote sellers must not collect all local taxes and remit through the Louisiana Sales and Use Tax Commission for Remote Sellers
- Consider California District Taxes
  - Administrative guidance from CDTFA indicates threshold must be reached in districts individually
- City Business and Occupation Tax in Washington
  - Physical vs. economic presence

# Wayfair Enforcement

## Marketplace Facilitators

- Many states have enacted statutes requiring marketplace facilitators to collect and remit tax on behalf of sellers
- Easiest way for states to achieve tax collection on remote sales
- Applies whether facilitator takes title and makes sale or not
- Many large marketplace facilitators were collecting tax prior to or shortly after *Wayfair* decision
  - Reduces favorable impact to states' budgets of enacting economic nexus
- Important consideration for on-line retailers
- Multi-channel sales considerations
  - Brick & Mortar
  - Company operated websites
  - Sales through marketplace facilitator

# Wayfair Enforcement

## Exemption Certificates

- Increased nexus footprint = greater exemption certificate requirements
- Ensure certificates properly completed
  - Understand acceptance requirements (i.e. good faith or “fully completed” certificate)
- Include in customer set-up process
- Process for updating customer taxability in billing system/ERP
- Importance of policy and process for tracking
- “Home grown” tracking and storage vs. third party software solutions for exemption certificate management



# Post *Wayfair* Compliance

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## Registrations

- Additional registrations required
- Carefully consider registrations where no taxable sales exist
  - Taxable sales vs. gross sales analysis
- Possible use of Streamlines Sales Tax Project registration process
- “Business State Date” for registrations
- Registering as of a date in the future
- Beware of questions related to other tax types
  - Withholding
  - Income/Franchise Tax



# Post *Wayfair* Compliance

## Registrations – cont'd

- Nexus questionnaires disguised as registration documents
- Sales tax vs. sellers use
- Simplified rate/registration programs (LA, AL, AZ)
- Secretary of State Requirements
- Certificates of good standing
- Hard copy mailings with account numbers or access codes
- Beware of business start dates driving past due returns
- Member/Officer personal information
- Responsible party ramifications

# Post *Wayfair* Compliance

## Developing a Multistate Compliance Process

- Consider return compliance software vs. versus manual spreadsheet method
- Compliance/payment outsourcing
- Importance of filing calendars
- Depending on fact pattern, consider collection and remittance in all states
- Consider local sales/use tax, especially in home-rule states
- Reporting requirements still an option in certain states (e.g. Colorado)



# Post *Wayfair* Compliance – Automation Solutions

## Sales Tax Rate Calculation and Tax Collection

- What does the system (or the Billing team) need to do?
- Use the following data points:
  - Customer Name/Number
  - Customer Address
  - Product/Service Sold
  - Sale Amount
- To accurately determine:
  - Situs of sale
  - Tax rate (with state and local breakdown for reporting)
  - Tax amount for invoice
  - Book tax amount to the correct payable account

# Post *Wayfair* Compliance - Automation Solutions

## Sales Tax Rate Calculation and Tax Collection - cont'd

- Home grown vs. third party software solutions
- Ability of billing system to collect tax
- “Bolt-on” software for real time tax calculation
- Have become more prevalent
- Very high cost but coming down
- Available software packages
- Tax rates – Staying up-to-date
- Nexus settings
- Invoicing format – correctly show sales tax
- Sales tax correctly mapped to Sales Tax Payable account
- Recommend by-state accounts or sub accounts

# Post *Wayfair* Compliance - Automation Solutions

## Customer Taxability

- Link billing system to exemption certificate module
- Manual application of customer exemptions in billing/accounting system
- Statutorily exempt customers (Federal Government, religious organizations)
- Exemption certificates may not be applicable to all sales for a given customer
- Application of exemption certificates to correct customer accounts
- Name on certificate vs. customer name in billing system



# Post *Wayfair* Compliance - Automation Solutions

## Product Taxability

- Importance of product taxability tables and mapping
- Taxability categories
- Job aids / matrices for manual processes
- Services vs. tangible personal property
- Statutorily exempt items
- Reduced rates (e.g. CA and MS)
- Line item taxability on invoice – Cannot apply to overall invoice
- Setting up products correctly to drive taxability
- Importance of upstream data input (product master, customer master)
- Sales tax holidays

# Post Wayfair Compliance

## Use Tax

- Consider use tax accrual processes (manual or automated)
- Still needed even with expanded nexus footprint of vendors
- Large potential exposure – Often overlooked
- Fixed assets vs. expense purchases
- Potential direct payment permits
- Monthly (or quarterly) review
- Accurate descriptions of purchases
- Include tax paid to vendor - More vendors charging tax may shift to overpayment review
- Providing exemption certificates to vendors identified
- Requires involvement of several groups

# Post *Wayfair* Compliance

## Reporting

- From billing system, ERP, third party facilitator or combination thereof
- Reporting should meet requirements of returns software, manual process or outsourced provider
- Likely will need combination of different reports
- Sales and purchase data
- Data compilation and preparation
  - Consider tools to consolidate information

## E-Commerce

- Confirm ability and willingness of third party e-commerce providers, facilitators and processors to collect tax
- Confirm availability (and viability) of reporting from providers
- Consider services offered by marketplace facilitators for tax collection
- Accounts payable aggregation and vendor management platforms





# Post *Wayfair* Exposure Mitigation

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- Perform analysis of sales by state
  - Overlay nexus thresholds
  - Consider customer exemptions (e.g. manufacturing and resale)
  - Consider product exemptions (e.g. food and medicine)
- Overlay income and franchise risk analysis
- Assess prior period risk
- Create tiered analysis of risk by state
- Create action plan for compliance
  - Go-Forward Compliance vs. VDA/Amnesty
  - Consider local sales/use tax, especially in home-rule states
  - Local business licenses may be required as well (e.g. TN business licenses)
- Interest/Penalty waivers

# Post *Wayfair* Exposure Mitigation

## Nexus Tracking

- Perform regular review of filing footprint
- Focus on sales amounts
- Importance of transactional thresholds in question
- Use of gross sales or taxable sales for purposes of thresholds
- Measurement periods
- Grace periods for registrations after nexus threshold reached
- Filing requirements for retailers in marketplace facilitator states
- Create tracking/reporting process
- Automation software ability to track sales and transactional thresholds

# Post *Wayfair* Exposure Mitigation

## Impact beyond remote sellers of taxable tangible goods

- Sellers of software, SaaS and taxable services beware
- Sellers of services in gross receipts tax states (HI, NM, SD, WV)
- Purchases
  - Expect additional vendors to charge tax
  - Fewer accruals for use tax required
- Manufacturers
- Wholesalers



# Unintended Consequences

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## Accounting Groups and Tax Departments

- Increased cost of compliance
- Increased internal resource requirements
- Possible need for increased headcounts and specific sales/use tax roles
- Tax Departments are not just for large company's anymore
- Interfacing with outsourced professionals
  - Data requirements and timing
  - Timely approvals
- Utilizing contractors

# Unintended Consequences

## Impact of Outside Tax and Accounting

- Accounts payable
  - Exemption certificates – request from vendors
    - Expect increase in activity post Wayfair
    - Potential for “bill back” of taxes by vendors
  - Reviewing invoices more carefully for tax charged by vendor
- Purchasing
  - Requests from vendors related to sales tax
- Fixed Assets
  - Establishing proper budgets for projects to include sales/use tax
- Accounts Receivable
  - More sales/use tax disputes with customers
- C-Suite
  - Increased exposure = increased office liability

# Unintended Consequences

## Income Tax – Factor Presence Nexus

- Whether physical presence is necessary to create income tax nexus has been a topic of debate for many years.
- Given the uncertainty of the concept of economic nexus, we began to see the adoption of factor-presence, or bright-line, nexus standards.
- Out-of-state corporations are deemed to have nexus for corporate income tax or gross receipts tax purposes where they have property, payroll, or sales in those states that exceed the statutory thresholds.
- States with a factor-presence nexus standard for income tax include Alabama, California, Connecticut, Colorado, Michigan, New York and Tennessee.
- States with a factor-presence nexus standard for gross receipts tax include Ohio and Washington.
- Washington recently updated its economic nexus standard for B&O Tax. Effective 1/1/20, the threshold will match the \$100K (gross income) sales tax threshold.



# Unintended Consequences

## Income and Gross Receipts Taxes

- As a result of Wayfair, states will likely be more aggressive in trying to impose income tax nexus
- *Wayfair* does **not** overrule P.L. 86-272
- More states are enacting factor-presence nexus standards for corporation income tax purposes (e.g. HI, MA, PA)
- Companies may need to evaluate their no nexus positions for income tax purposes
- Companies should continue to assess if they can take a de minimis or economic presence only nexus position
- Companies should also evaluate any potential financial statement implications
- Possible new gross receipts taxes



# Looking Forward

# Looking Forward



## Outlook for 2020 and beyond:

- Increased enforcement efforts targeted at sales tax collection
  - Taxing jurisdictions shifting focus from purchase audits to sales audits
- Use “desk audits”
- Audits including post-Wayfair periods
- Auditors will scrutinize nexus positions for periods prior to economic nexus effective dates
  - Other nexus drivers will come into play (click-through, affiliate, cookie)
- Increased level of aggression after COVID-19 threat passes and possibly before
- Continued use of “big data” to identify audit targets
- Automated notices
- Nexus questionnaires

# Looking Forward

## Amnesty/Voluntary Disclosure Programs

- Have not seen state's pushing VDA programs as expected
- Expect amnesty programs may be introduced in state legislatures
- Possible use of amnesty in conjunction with COVID-19 relief
- Ohio HB 609 introduced in April
  - Related to COVID-19
  - Passed by House, Currently in Senate
  - Amnesty 1/1/2021 through 3/31/2021
  - Virtually all taxes
  - Interest and penalties waived
  - Unlimited lookback period for non-filers
- Amnesty normally available for registered taxpayers where VDA may not be
- Determine whether to use amnesty or VDA program

# Looking Forward

## Impact to Mergers and Acquisitions

- Sales/use tax was front and center even prior to Wayfair
- Already seeing additional scrutiny and issues related to increased nexus
- Buy side assuming the worst
- Escrows established
- Beware of post-deal voluntary disclosures handled by buyer
- Asset purchases vs. stock/membership interest
- Importance of tax language in deal documents



# Looking Forward

## Impact to Mergers and Acquisitions – cont'd

- Buy Side
  - Importance of detailed analysis at state & local level
  - Successor liability (applied to asset deals as well)
  - Focus on exemption certificates
- Sell Side
  - Get your house in order
  - Sales/Use tax is an easy target
  - Documentation of studies conducted and exposure mitigation employed
  - Document reasoning for lack of action in certain states
  - Retain control over prior period exposure mitigation

# Looking Forward

## Additional Considerations

- Software enhancements and developments
  - Take advantage of updates
- Consideration for tax functionality in newly developed marketplace software platforms
- Additional simplification in states with home rule jurisdictions
- Litigation and controversy around nexus in periods prior to Wayfair



# Questions?





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