Wayfair Gives States 'Just What They Need'

by James Ford

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In this viewpoint, Ford explains compliance issues companies may face after *Wayfair* and the technology that could help them meet their new sales and use tax registration and filing obligations.

The Wayfair jingle is a catchy one: "Wayfair, you got just what I need." States are starting to hum this tune, too. And "just what they need" is more revenue in their coffers. It's hard to avoid news stories on state sales tax the last few weeks thanks to the U.S. Supreme Court's overturning of *Quill Corp. v. North Dakota*.[1] *Quill* established a physical presence standard for collecting state sales and use tax in 1992, but reading the opinion makes one quickly realize that technology has advanced well beyond the confines of a floppy disk.

The age of the internet has changed how businesses operate and created uncertainty regarding state tax. These changes have created huge gaps in state sales tax coffers that the states have struggled to stabilize — namely, the growth of internet-based sellers and changes in purchases by businesses. The lack of response to these changes compounds the issues. Although the fallout from *South Dakota v. Wayfair Inc*.[2] has not settled, there are some common themes businesses should start to understand so they are better prepared for the new sales tax collection standard.

There has been a lot of buzz about the decision only affecting online retailers. Sure, online retailers helped to highlight the problem and made it newsworthy, but *Wayfair*'s reach goes far beyond online retailers. The case affects any business that sells products and services across state lines. All businesses engaged in interstate sales should take note.

Ultimately, this is a nexus issue. When can a state determine that a business has sufficient presence in its jurisdiction and therefore compel it to collect taxes? *Quill* established physical presence as the sales and use tax nexus requirement; *Wayfair* overturns that standard. Certainly, the internet has made the argument stronger, but what is most important to realize is that any bar, once lowered, applies to all businesses, not just those with an online presence.

A Complexus of Nexus

It's all about nexus — economic nexus, marketplace nexus, reporting requirements, affiliate nexus, and click-through nexus. These are all new terms that have been added to the indirect tax lexicon over the last few years. With *Quill* overturned, the states will start formulating their approaches to lower the nexus bar. Congress may still act, but in the absence of any congressional action, states will certainly move toward a more economic-based nexus model that attempts to identify those businesses gaining a benefit from their markets and subsequently force them to collect and remit their state and local taxes.

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[1] 504 U.S. 298 (1992).

[2] 585 U.S. ___ (2018).

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Current States With Reporting Requirements

Companies doing business in these states should reconsider their approach to registering and collecting sales tax.	
State	**Reporting Requirement**
Alabama	July 1, 2017
Colorado	July 1, 2017
Connecticut	December 1, 2018
Georgia	January 1, 2019
Iowa	January 1, 2019
Kentucky	July 1, 2013
Louisiana	July 1, 2017
Oklahoma	June 9, 2010, and November 1, 2016
Pennsylvania	April 1, 2018, and April 1, 2019
Rhode Island	August 17, 2017
South Dakota	July 1, 2011
Tennessee	March 26, 2012
Vermont	May 24, 2011, and July 1, 2017
Washington	January 1, 2018

Source: Sales Tax Institute https://www.salestaxinstitute.com/resources/remote-seller-nexus-chart

Reporting Requirements

States' perceived issues with the *Quill* physical presence standard are not new because they have been consistently testing *Quill* over the last 10 years. As states' sales tax revenues declined due to remote sales, they reacted with more aggressive enforcement and auditing of existing taxpayers and policy changes that sought to increase the taxable base. We've seen this evolution with more states imposing taxes on previously nontaxable services and expanding the taxability of items like software. Pennsylvania even floated a proposal to tax professional services last year, which would have been a first in its history.

These two tactics helped alleviate some of the pain, but neither ultimately addressed the lost revenue problem. A third approach appeared on the horizon as states began to push the limits of what constitutes nexus. The concept of sales reporting and notification requirements was introduced in Colorado to potentially identify untaxed sales and compel the purchasers to self-asses the use tax. One of the arguments against overturning *Quill* was that states have already addressed the issue of noncollecting remote sellers by demanding the in-state taxpayers self-assess use tax on purchases that would otherwise be subject to sales tax. But whereas sales tax compliance is high, use tax compliance remains low. States believe that part of the low compliance rate is due to the lack of reporting around those sales. Use tax bills are typically only generated during an audit; as such, it's not an efficient way to enforce compliance. Reporting requirements provide states a quick way to determine which of their taxpayers are purchasing from remote sellers and, in theory, gives them a way to cross-check that against use tax paid by the taxpayer in the state. It also notifies the taxpayers that they may have made a significant amount of untaxed purchases.

Seven states implemented reporting requirements before *Wayfair*. More states announced immediately after the decision that they would also enact reporting requirements. Reporting requirements don't require businesses to officially register to collect the state sales tax; rather, they establish thresholds for annual reporting that would be required in lieu of collecting. Reports may have to be sent to customers indicating the total amount of tax-free purchases they made. Those same reports may also have to be sent to state taxing authorities.

After *Wayfair*, states that were on constitutionally shaky ground are now firmly justified and these requirements may have already been implemented. This is one of the first important areas to address post-*Wayfair*. Those responsible for sales tax collection and remittance should ask themselves:

- Does my business operate in one of the states that have already implemented reporting requirements?
- Are there more states enacting changes that take effect in the fourth quarter that I need to worry about?
- What type of data do I need to report to my customers and taxing authorities?

Reporting requirements could have a multitude of effects. Obviously, customers who

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have not been self-assessing use tax might take a second look at their purchases and their procedures knowing that their vendors are now required to report to taking authorities. Our clients are primarily large corporations, and we have seen some of these companies compel their vendors to collect the state's tax. Don't be surprised if some customers request that you charge sales tax going forward. It may be a requirement for their continued business.

Registration

Once a business has decided that it is going to collect these taxes, it needs to look at requirements to do business in the state. Registration is usually a simple process but may vary by state. A business has the option of registering centrally, but if it does so, it may be automatically registered for all states that participate in the program. Be prepared to provide some personal information for owners or officers. This seems simple enough, but the scrutiny over the security of personal data could make this a challenge.

When contemplating registration, businesses should consider what approach makes sense. Many of our clients are evaluating the possibility of registering everywhere versus rolling out registrations over time. Registration — if a company is not doing business in a state — can be outsourced. Otherwise it can easily consume in-house resources, considering the secretary of state registrations that may be required, individual sales tax registrations that must be completed, the litany of follow-up questionnaires and forms to validate, and ensuring that the business is not subject to the other state taxes. Businesses should also consider what to do about states with home rule reporting of local taxes. Most local sales and use taxes are collected at the state level, but there are more and more local taxing authorities popping up every year. Home rule jurisdictions require separate registrations for local taxes and may also require separate return filing.

Tax Calculation

If a business has only operated in a few states or has been based in a single state, it may need to consider how to calculate sales and use taxes for other states where registration is required. Just because a company is compelled to register does not mean it should collect the tax. Sales for resale, sales to exempt organizations, and sales of products or services that are generally not taxable will not change when these laws are sorted out — this is just a question of nexus.

If a company determines it needs to collect the tax, and its products and customers are taxable in that state, it must decide how to apply these taxes to its invoices. The application of tax is a real-time exercise, and this is a project that involves a lot of stakeholders. Company employees will be dealing with accounts receivable, accounting, tax, and information technology, so consider that in the implementation plan. Any process that touches invoices will need to be thoroughly tested, so businesses should not take this exercise lightly. The following table shows three potential solutions.

Tax Collection Solutions

Tax engine	Content (rates/rules)	Cloud-based solutions
A stand-alone solution that can be "bolted on" to a billing system. Some systems provide tax rates only and leverage billing systems' functionality for taxability, while others do all the calculations in the system and pass tax back to the general ledger and invoices.	Most invoicing systems have at least a rudimentary tax calculation functionality. A company may be able to purchase content consisting of tax rates that can be loaded into the system. Tax rates change monthly, or even midmonth, and maintenance must be considered. Taxability rules can also be implemented and updated through a content provider.	There are cloud-based solutions that can integrate with billing systems, point-of-sale systems, and legacy billing systems. Cloud-based solutions can bring both tax rates and taxability to invoices.

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Monthly Sales and Use Tax Compliance

Once a company is registered, it must file returns. Even if its sales will not be taxable, the business will still be required to file returns at the prescribed frequency. Sales taxes follow a monthly cycle and are trust fund taxes that must be remitted to the taxing authorities — generally in the month following the end of the tax period. However, there are less frequent filing requirements. Many states have quarterly reporting and others have annual and semiannual reporting options. Filing frequency is usually determined based on average tax liability or average gross sales — but this can vary by state. If businesses are unsure, they should estimate low when registering. States reevaluate frequencies each year, so once a fact pattern is established, the taxing authorities will notify the company if it needs to change.

Be prepared to make these filings and payments electronically, which is both a blessing and a curse. Thresholds for mandatory electronic payment are low in many states, and many states have eliminated paper returns and have no threshold for requiring electronic transmission of returns.

Because they will file 12 times a year, businesses should use automation when they can. General account reconciliations, payments, and return filing data preparation all must be done monthly. In the sales tax world, businesses are often dealing with large data files that can be unwieldy. They should build an end-to-end process that leverages automation whenever they can.

Exemption Documentation

In the old paradigm, a distributor would only register where it had physical locations. Distributors are generally exempt from sales tax collection because their sales are for resale. *Wayfair* is not going to change that. If a company's sales are for resale, it may be compelled to register, but not necessarily collect the state tax. It will, however, have documentation requirements under the new regime. The burden of collecting and maintaining exemption documentation is on the seller. Although it may not have a sales tax collection burden, if it is required to register, it must maintain exemption documentation to assure that during an audit, those sales are not deemed taxable and included in its assessment.

Businesses should consider automation in this area as well. The burden of collecting and validating certificates is not an easy one — it's an ongoing process. New customers must be set up and documentation will need to be received and maintained. In addition, many states have mandated that certificates expire either annually or every two years, so this is a process that will require maintenance.

The other issue is that this task usually must be shared between two groups. Tax does not want to be involved in accounts receivable operations or setting up new customers — nor should it be. Here again is where automation can help, as the company may be able to develop a workflow that includes a tax review but does not hold up the process for new customers and invoicing.

Other Issues

When a business registers to collect sales and use taxes, there may be other implications to consider. Does the company distribute free goods or samples? Are there other items that, once registered, will create a use tax obligation? Are there promotional materials that are sent to states?

Before registration, this may not have been an issue as the company did not have nexus. But if *Wayfair* requires registration, businesses should also consider some of these business activities that may have been in place for years. Are there business practices that, prior to any changes in state sales tax nexus rules, would have been cost neutral but now are cost creating? Companies must consider how these changes can affect business outside of just sales and purchasing.

Conclusion

There is still a lot of *Wayfair* fallout yet to settle. Congress is meeting to discuss what action, if any, it will take. States are considering their options and announcements are forthcoming. If nothing else, businesses should start considering the potential changes and their effects. Sales and use taxes are indirect taxes, that if passed on to customers minimize the impact to the bottom line. If a business doesn't properly implement or consider these issues, it becomes liable during audit. ■

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