taxconnex

Sales Tax Nexus Guide

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Overview

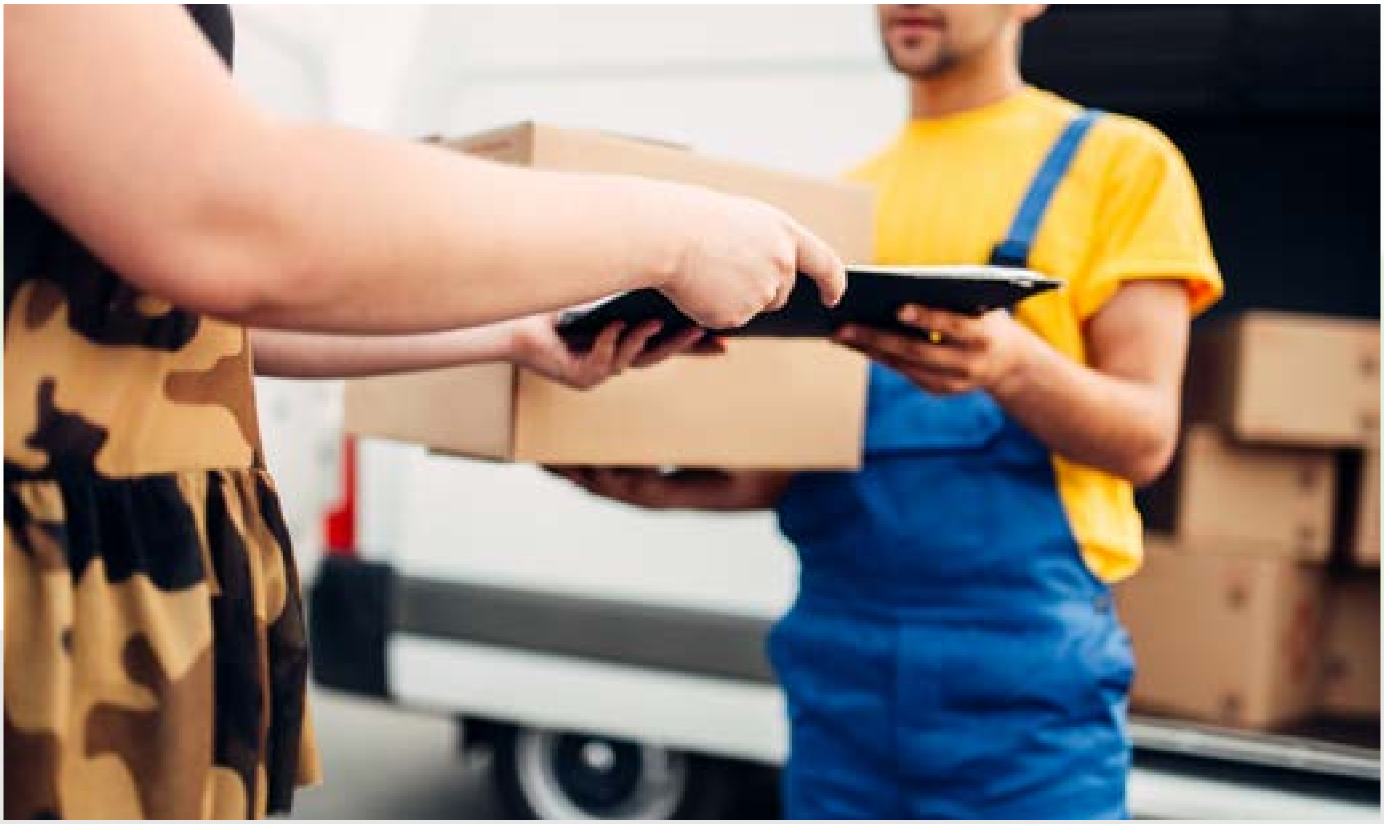
Sales and use tax nexus refers to the connection between a person or entity and a taxing jurisdiction sufficient for that jurisdiction to require the person or entity to comply with its sales and use tax laws. The current basis for determining when sales and use tax nexus exists is found in three United States Supreme Court cases; *National Bellas Hess, Inc. vs. Department of Revenue of the State of Illinois [May 8, 1967]; Quill Corp. vs. North Dakota [May 26, 1992], and South Dakota vs. Wayfair, Inc. [June 21, 2018].*

In both Quill Corp. and National Bellas Hess, Inc., the Supreme Court ruled in favor of the taxpayer, limiting the states' ability to impose its taxing authority over interstate commerce. The guidance derived from these two cases sets the basis for determining whether a business has a physical presence substantial enough to create sales tax nexus. The Wayfair case changed sales tax nexus determination significantly by allowing states to attach sales tax nexus to a business by simply selling into a state. This type of nexus is often referred to as economic nexus.

With nexus being the foundational element that requires a company to collect and remit sales tax, it's important to note some of the difficulties in determining whether a company has sales tax nexus or not. While the economic presence seems clear (it really is not), the physical presence test is very interpretational. Furthermore, while the economic presence standards are more in the mainstream media, they have not replaced the physical presence standards that have been in place for the last fifty plus years. Let's first take a closer look at economic nexus and then physical nexus.

Economic Nexus

South Dakota v. Wayfair, Inc. has led to the largest change in sales tax in the last 50 years. Since 1967, businesses have operated under the premise that a substantial physical presence is needed in a state in order for said state to subject the business to their sales tax collection and remittance requirements. "Substantial physical presence" has always raised questions as to what that really means. Is one meeting by a sales rep with a prospect substantial? Maybe. What about exhibiting at trade shows? Maybe – depending on the state. Over the last roughly five to ten years states have taken aggressive positions as to what substantial physical presence means. In some cases, even noting that web-based "cookies" that are used in browsers create substantial physical presence.



With Wayfair, the initial hope was that nexus would be simplified. Defining nexus as a certain amount of sales and/or a certain number of transactions. This has been described as economic nexus. However, in looking at economic nexus rules from state to state, many are different. The dollar threshold of sales can differ, whether taxable sales or gross sales are considered, whether sales in the previous calendar year or last twelve months are counted, and many other variables as well.

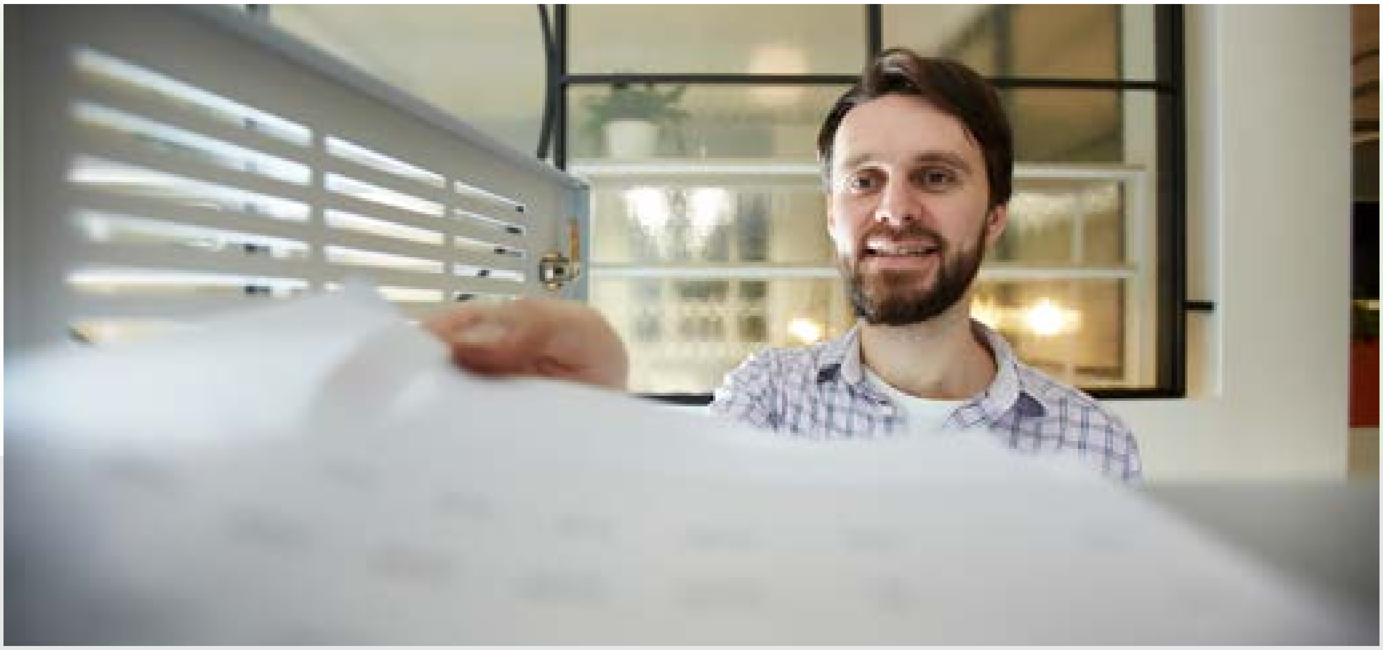
One of the great misnomers is that economic nexus replaces physical nexus. In fact, economic nexus does not replace physical nexus – it's additive. Rather than simplifying the nexus debate, businesses must not only consider whether they have a physical presence, but now they must also look at the complicated economic nexus rules from state to state.

Additionally, these economic nexus rules are constantly in flux. Since the Wayfair ruling in June 2018, forty-three states have introduced some type of economic nexus rule. We have seen multiple states come into the fold each month since the Wayfair ruling was first handed down.

This is not just an internet retailer phenomenon. Internet retailers are the focus, but a host of other businesses are being pulled into this. The economic nexus rules are targeting businesses that don't have physical presence in a particular state. So a traditional business that may not have any internet presence can easily be swept up in this if their sales activity and transaction volume is sufficient enough.

Most of the thresholds are $100,000 or 200 transactions, but some stateslike Pennsylvania and Washington have a $10,000 threshold. While states like Alabama, Connecticut, Georgia, and Mississippi have $250,000 thresholds.

A thorough review of all sales activities including transaction volumes should be looked at by each business. Not every business will be willing to pay the fees associated with a formal economic nexus review. If nothing else, all businesses should review the last twelve months of sales activities and see if any states have more than $100,000 in sales. While this is not a 100% accurate method, it's a first guide that would suggest the need for a deeper dive into that specific state to determine if the economic nexus thresholds have been crossed.



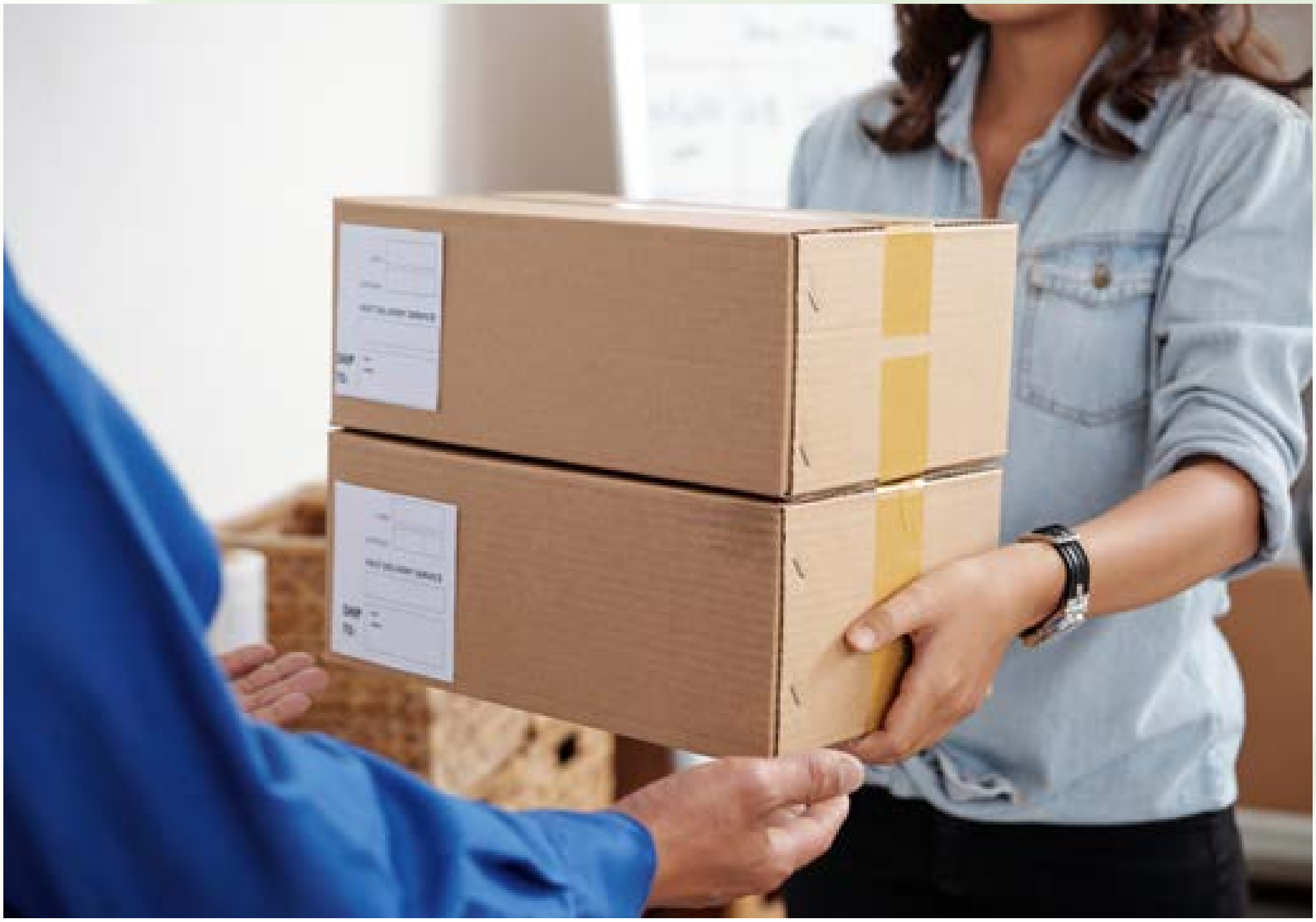
Physical Nexus

As referenced earlier, the physical presence test in determining sales tax nexus has been the law of the land for more than fifty years. Over that period of time, the activities that create a physical presence have changed with states taking more aggressive positions in the last ten years leading up to the Wayfair case and the new economic presence rules. Some of the physical presence tests are easy to understand – having an office in a state, having employees in a state, owning inventory, etc.However, there are some additional physical presence creating activities that need to be considered, and we will highlight some of these below:

"Amazon Laws" and Click-Through Nexus

The internet has resulted in a shift in our buying patterns and a decline in sales tax revenues. Prior to Wayfair, an out-of-state retailer (translation – a retailer without nexus in the state) selling goods to a consumer or business over the internet is not required to collect sales tax. (There are a few exceptions that we will discuss later.) It is the buyer's responsibility to self-assess the tax and voluntarily remit use tax to the state. Most businesses are aware of this nuance but many consumers are not.

States enforce these rules with businesses through audits; however, the states don't have the bandwidth, nor is it practical, to audit every consumer. This is the genesis of "Amazon Laws" or "click-through nexus" rules. Each is a



way in which states have tried to use the physical presence standards to require out-of-state retailers to collect the tax that otherwise would not have been collected. The typical scenario is where an out-of-state business forms a relationship with an in-state business (often referred to as an affiliate) for the sole purpose of customer referrals via a connection to the out-of-state business's website. For this referral, the in-state business receives some type of commission or other consideration. The relationship established through the affiliate programs creates a physical presence and thus sales tax nexus for the out-of-state business.

Companies should review their affiliate programs and understand which states, specifically, have "Amazon Laws" or "Click-Through Nexus" rules. This is a constantly changing area that requires close monitoring.

Traveling Sales Representatives

The idea of a sales representative sitting in a home office in a state other than where corporate headquarters is located is a pretty clear example of an activity which establishes sales tax nexus in the state where the sales representative is based. What happens when that sales representative travels into other states to meet with prospects or customers? This type of activity frequently occurs with businesses as the sales representative meets with the prospect to demonstrate their product. Whether or not this type of activity creates sales tax nexus will depend on the state and the frequency of the activity. Each state's rules are slightly different in terms of the threshold that needs to be met in order to create nexus. However, for some states, a sales representative traveling into the state for a single day will create sales tax nexus. While other states have more lenient thresholds, a general rule-of-thumb is that three days of activity of this type will create nexus for sales and use tax purposes.

Instead of face to face customer presentations, businesses may consider conducting product demonstrations via the Internet through Webex, GoToMeeting, or another similar application.

Trade Shows

Some companies are frequent exhibitors at trade shows. Typically, companies attend trade shows to promote their products and services. A company may promote its products and services via representative employees or agents and/or display its wares via a kiosk or booth. In either of these scenarios, the company is performing a type of solicitation. It is the solicitation activity that determines whether or not a physical presence has been established. However, a number of states have established specific thresholds (number of days in attendance at a trade show) in order to establish when a company attending a trade show has created nexus in the state.

For example, California has set a standard of more than fifteen (15) days – i.e. if you attend trade shows in California for fifteen days or less, you have not created nexus in the state of California (assuming this is your only activity within the state). ***Cal. Rev. & Tax. Cd. §6203(d) ; Cal. Code Regs. 18 §1684(b)***

Businesses should carefully plan where they will participate in trade shows and understand the sales tax nexus thresholds associated with each state for this type of activity.

Employees or Agents Performing Services

Businesses that send employees into a state to provide implementation, installation or repair services are creating nexus for sales and use tax purposes. The fact that this is a non-selling or non-solicitation activity does not mean this activity does not create sales tax nexus. On the contrary, these activities are more likely to create nexus for sales and use tax purposes.

Using non-employees to support clients can have a similar affect. For example, a business that uses a local resource to repair or perform other maintenance for its customer is providing the service via an affiliate and is deemed to have created nexus for sales and use tax purposes. Whether the person providing the service to the customer is an employee of the business or not is immaterial to the states. The fact that the person is present in their state and performing a service on behalf of the out-of-state business is sufficient to create nexus for the out-of-state business.

Businesses should evaluate non-selling related activities they perform in each state including installation and maintenance/support services as well as services provided via third party representatives when assessing their sales and use tax nexus foot print.

Reporting Requirements

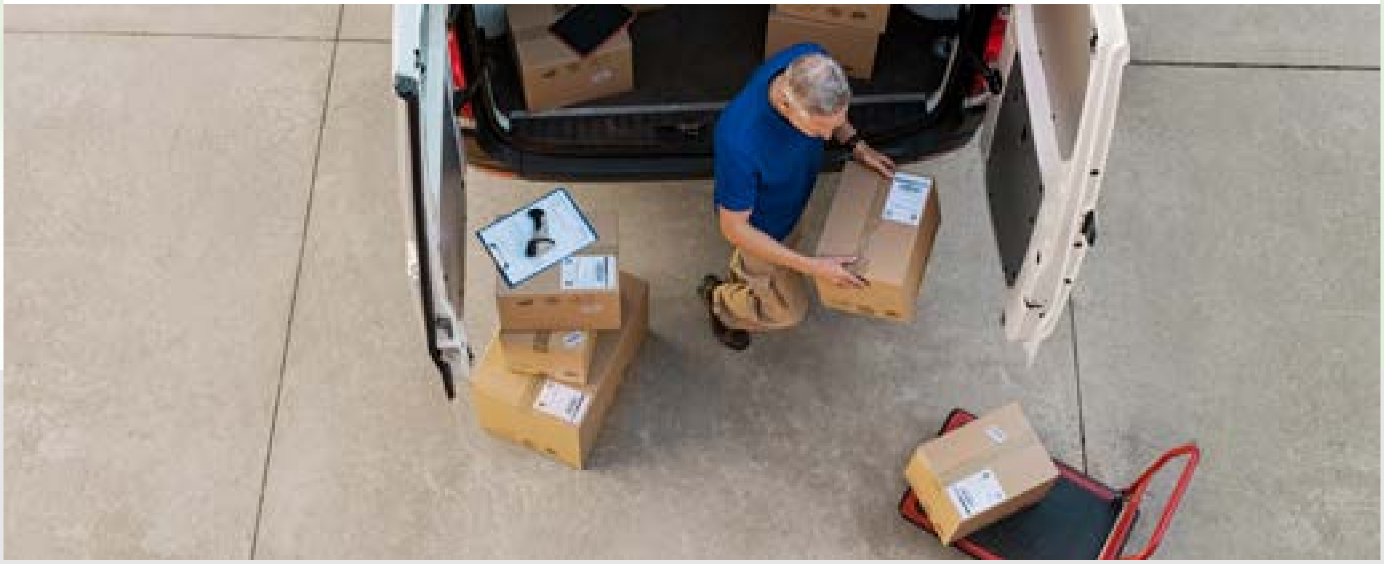
Other states have taken the route of requiring out-of-state sellers to report to the state those customers that made purchases from them in the previous calendar year. In some situations, these reporting requirements also direct the out-of-state seller to notify their customers of the customers' requirement to report the use tax directly to the state. The intent is for the state to have the ability to pursue the use tax collection directly from the end customer. Colorado was one of the first states to implement this type of reporting requirement. It has been challenged legally, but it has been upheld. The reporting requirement went into effect in Colorado as of July 2017. There is a de minimis amount whereby the out-of-state seller is exempt from the reporting requirement if they have less than $10,000 in sales into Colorado.

Businesses should be aware of these reporting requirements including the de minimis standards in each state.

Sales Tax Nexus and FBA Sellers

Amazon FBA (Fulfillment by Amazon) Sellers have been recent targets for states. Many businesses use Amazon's FBA program to help them promote, sell, and ship products and even manage customer returns. In the FBA program, Amazon is managing consigned inventory that is owned by the seller. For those of you versed in sales tax nexus, you know that owning inventory in a state typically creates sales tax nexus. The potential issue for sellers using the FBA program is that Amazon has the ability to move the inventory from location to location in order to optimize the supply chain. This means the seller doesn't always know where their inventory is located. Inventory can be in any state where Amazon has a fulfillment center. A recent development as of Q4 2017 is for states (California specifically) to send letters to FBA sellers asking them to complete a nexus questionnaire with the presumption that the state already knows the seller has consigned inventory in the state.

FBA sellers would be wise to review monthly in which fulfillment centers their inventory is present.



Summary

Establishing sales tax nexus is often the culmination of multiple nexus creating activities. For example, a business may spend three days in a state soliciting orders, two days at a trade show, and a day or two implementing their products. Each of these activities can create sales tax nexus by itself but should also be viewed in relation to other nexus creating activities.

Furthermore, a business can create sales tax nexus via purely economic activities such as deriving revenue from within the state or through a certain number of transactions/invoices.

An important note is that once sales tax nexus has been created, the need to collect and remit sales tax is triggered (assuming what you are selling is taxable in the particular state). Sales tax nexus is associated with the legal entity and spans all sales channels. For example, if you have a direct sales channel and an internet sales channel, once nexus is established in a state both channels are subject to the sales and use tax laws of that state.

About the Author

Brian Greer, Partner, Vice President of Sales and Marketing

A graduate of Purdue University, Brian has a rich background in serving the Technology and Accounting industries, while leading successful sales and marketing teams. Brian began his career as an Account Manager for Firstwave Technologies, selling customer relationship management solutions to large, nationwide businesses. Later he joined JD Edwards (subsequently acquired by Oracle) where he used his technology experience to successfully sell enterprise solutions to Fortune 500 tax and accounting departments. Brian leveraged his technology and accounting backgrounds in 2001 by joining Tax Partners as an Executive Account Manager, initially developing sales, transaction, and telecommunications tax solutions through the professional accounting channel...primarily through partnerships with the Big 4 accounting firms. He later led the sales and use tax sales team after the Thomson Reuters acquisition, growing the revenues to multi-million dollar levels. Brian joined TaxConnex as a partner in 2010, guiding the sales and marketing activity and giving TaxConnex a uniquely talented technology and sales tax professional.

About TaxConnex

TaxConnex is a sales, use, and telecommunications tax consulting, advisory and outsourcing firm. We provide our services to businesses of all sizes with a focus on small to mid-market companies, telecommunications firms, and companies that are underserved by a one-size fits all sales tax outsourcing arrangement. Our services are customized for each client and delivered by our skilled and expertly trained practitioners.

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