State Tax Observations

Under *Wayfair*, Online Retailers Have A Bigger Sales Tax Collection Burden. What Now?

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Quill was killed. As of last week, *Wayfair* is in charge. The United States Supreme Court made clear, in its highly anticipated *South Dakota v. Wayfair* decision, that the nexus standard has changed in the sales tax arena. Online and remote retailers now must collect sales tax from customers in states even when they have no physical presence in those states.

Specifically, retailers must collect sales tax in states that have sales tax economic nexus laws. Right now, such laws exist in 16 states, but of course that number is expected to grow as states piggyback on the result. In fact, North Dakota, Minnesota, Louisiana, Maryland and New Jersey have already issued guidance and press releases in response to *Wayfair*. For example, in New Jersey, each house of the New Jersey legislature quickly introduced bills that would adopt an economic nexus law identical to South Dakota's. The collection obligation would begin the first day of a calendar quarter 90 days following enactment.

The 5-4 *Wayfair* decision overturns 50 years of precedent including the 1992 Supreme Court *Quill Corp. v. North Dakota* decision that required retailers of goods and services to have physical presence (of property or employees) in a state before the state can impose a sales tax collection requirement on them. (Who knew the Dakotas would play such a key role in the country's sales tax landscape?) The Court sided with South Dakota, ruling that the physical presence standard in *Quill* was "unsound and incorrect." The Court characterized the *Quill* standard as a "judicially created tax shelter" that benefited internet retailers that limited their physical presence to one or two states, but sold goods and services to consumers in multiple states.

It should be noted that technically *Wayfair* has been remanded to the South Dakota Supreme Court to determine whether there are any other constitutional concerns with the South Dakota law. Also, *Wayfair* only addresses sales tax laws. It does not address state income tax (or the P.L. 86-272 protection thereunder). A number of states have already enacted economic nexus standards regarding income taxes.

Who is impacted by the *Wayfair* decision?

Any retailer that sells goods or services online or from out-of-state (including foreign sellers) could be impacted by the Supreme Court decision. Sellers of everyday tangible property from furniture to clothes to household appliances to electronics are affected. So are sellers of consulting, information services or computer services [including software as a service (SAAS)] and sellers of electronic media, such as books, music and movies.

One interesting situation occurs with art dealers who deliver art remotely. Many art sales will exceed most state sales tax economic thresholds (such as the $100,000 threshold discussed below) with just a few transactions. For example, prior to *Wayfair*, art dealers were able to ship art sold in New York to a remote state such as South Dakota or Alabama, without sales tax being collected. Now, they must collect.

The decision, in particular, is not pleasant news for large or midsize online retailers that are flourishing. If these online retailers including Wayfair, Overstock and Newegg (which were parties in the *Wayfair* decision) were not collecting sales tax in states other than where they had physical presence, they will need to do so now. The tax collection could erode some of the competitive advantage over brick and mortar competitors that these online companies had. The increased cost to consumers also may lower overall sales for these retailers. And there certainly will be an increased administrative and compliance burden for these companies.

Some super online retailers like Amazon are already collecting sales tax in a number of states with bright line economic nexus thresholds similar to South Dakota's. They may not be as greatly impacted.

What about smaller online retailers? Depending on the amount of their sales, they may fall under the threshold for sales tax collection responsibility. The South Dakota law, for example, requires retailers that make sales of goods or services into South Dakota to collect and remit sales tax to the state if either:

1. The seller's gross sales from goods and services in the state exceed $100,000; or
2. The seller engages in 200 or more separate transactions of goods or services delivered in the state.

So, the smaller retailer may avoid a difficult compliance obligation.

Online consumers, of course, are not winners under *Wayfair*, as their sales tax burden will now increase. Of course, they always owed the sales tax, there just was no mechanism to enforce the payment of it. Now, at least, there will be a consistent application of the sales tax authority.

Who are the winners?

Brick and mortar retailers, with a relatively small or no online presence may be rejoicing, at least in the near run, now that there is a leveling of the playing field. But will any retailer without an online presence be able to survive in the future?

Of course, the states are the biggest winners. States had long complained that they were losing out on an enormous amount of lost sales tax revenue. That amount is estimated to be at least $8 billion per year. The loss would have grown had *Wayfair* been decided differently.

What actions should online remote retailers take?

In light of *Wayfair*, retailers selling goods or services online or remotely are advised to evaluate their sales tax collection responsibility. Specifically, retailers should immediately take these steps:

- Gather data on gross revenues and/or the number of transactions that occur within states where the company sells remotely;
- Conduct a nexus study analyzing on a state-by-state basis whether or not economic presence (as well as physical presence) creates a sales tax collection responsibility;
- In each state where nexus now exists, understand the sales tax collection responsibility threshold;
- Determine for each relevant state which sales are taxable and whether any exemptions exist with respect to the goods and services being sold;
- Prioritize states where the company has the greatest economic presence and create a plan to collect and remit sales tax. Future sales should include sales tax and invoices should state the sales tax due;
- Consider back-year exposure and voluntary disclosure agreements; and
- In the prioritized states, register for sales tax purposes and start filing sales tax returns.

Contact Us

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