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Tax Notes

International Tax Considerations in Light of South Dakota v. Wayfair, Inc.

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U.S. sales and use tax is governed on a state and local level. Compliance with rules and regulations has always been a challenge for multinational companies. A Supreme Court decision from last year has had a massive impact on internal processes and even business models of multinational companies operating in the U.S. The impact is the result of new rules and regulations introduced by state legislatures following the Supreme Court decision.

Overview

On June 21, 2018, the U.S. Supreme Court in the case of South Dakota v. Wayfair, Inc., 585 U.S. (2018) significantly expanded the taxing authority of states of the United States with regard to sales and use taxes. The Supreme Court in the Wayfair case created the concept of “Virtual Presence” to describe the connection of large retailers to a state, especially online retailers who engage in a significant amount of business with a state in which the retailer does not have a physical presence.

The central issue in the Wayfair case was whether an out-of state seller without a sufficient presence in the purchaser’s state can be required to collect and remit sales tax to the purchaser’s state tax authority. The question was never whether the sale of goods or the provision of services to the purchaser was subject to sales/use taxes in the purchaser’s state, it was solely the question of which party to the transaction — the seller or the purchaser — was required to remit the tax on the transaction to the state.

Until the Wayfair case was decided, the authority of the states to require sellers of goods and services to collect and remit sales and use taxes was limited to transactions in which the seller had sufficient presence in the state where the purchaser of the goods or services was located. If the seller was not obligated to collect and pay the sales tax, the buyer was expected to remit the tax to the state. The crucial factor was defined in the case of Quill Corp. v. North Dakota, 504 U.S. 298 (1992) which held that the seller would be responsible for collecting and remitting the sales tax to the buyer’s state provided the seller had a physical presence in the state where the buyer was located. An earlier Supreme Court case, National Bella Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753 (1967), had preceded the Quill case.

International View

From an international perspective, the Wayfair decision, intended to stop revenue loss to states on interstate transactions, is another consequence caused by the “Cyber Age.”

A prime example of the tax complexities created by internet sales is that of Amazon and its system of hubs for the fulfillment of orders. Even if a Double Tax Treaty (DTA) would apply to preclude a foreign seller from having a U.S. taxable presence for corporate tax purposes — because inventory by itself, used only to fulfill orders, does not create a permanent establishment and, further, would prevent application of state corporate income tax because the location of the fulfillment hub is in a state which follows federal tax law (including DTAs) — this would not under Quill (in-state sales) or Wayfair (out-of-state sales above a certain

threshold) prevent a state from demanding the seller to collect sales tax on in-state sales and out-of-state sales.

In the European Union, the same issues have led to a new EU Value Added Tax (VAT) system which is intended to simplify VAT obligations for cross-border sales of goods and services to final consumers and will come into force in 2021.

The Role of Double Tax Treaties

For non-U.S. vendors selling to customers in the United States, the Wayfair decision is merely another example of the fact that DTAs between the United States and other countries do not cover or protect against many aspects of U.S. tax law; in particular, the array of tax laws enacted and applied by the individual states and local jurisdictions within the states. Taxes levied by the states include corporate income taxes, corporate franchise taxes, personal property taxes, and sales and use taxes. A significant problem with the sales tax regimes is that they are creatures of the states, thus the large number of such regimes (45 states impose sales taxes) each with its own rules, definitions and rates.

In many, if not most, of the states, registering to collect sales tax will automatically bring a request from the state's Secretary of State or Tax and Revenue Department that the entity register or qualify to conduct business in the state. This will bring with it the obligation to file corporate tax returns and appoint a registered agent in the state for service of process. The source of this problem is the concept that if an entity is collecting sales tax in a state it must have a physical presence in the state. [See comments regarding Quill, above.]

How nexus for corporate taxation will be determined after the Wayfair decision —which concluded that no physical presence is necessary if certain sales criteria are met — is an open question. Although annual sales of \$100,000 or 200 separate sales transactions may seem to be reasonable thresholds, even the Chief Justice of the Supreme Court, John R. Roberts, thought these sales levels would create an undue burden on small business. Nevertheless, lacking any other guidelines, 30 states have adopted the \$100,000/200 standard.

Key Takeaway

Multinational companies selling tangible property or providing services into a state without having physical presence need to monitor very closely state activities in the wake of the Wayfair decision and have to implement internal processes to track all kinds of sales into different states. If thresholds are exceeded, sellers not only have to register to collect sales tax but may also have to fulfill requests from state Secretaries of State and/or Tax and Revenue Departments to register or qualify to conduct business in the state. They may also have to comply with corporate income tax rules and regulations and appoint a registered agent in the state.

Contact Us

We welcome the opportunity to speak with you about any questions you may have regarding this article, including methods to reduce the impact of Wayfair on your existing or planned U.S. business or any other subject related to accounting, audit, tax or advisory matters. Please contact your PKF O'Connor Davies' account team or any of the following:

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