HOW TO DEAL WITH THE IMPACTS OF WAYFAIR

August 2018
With You Today

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HOW TO DEAL WITH THE IMPACTS OF WAYFAIR
The **Wayfair** decision
- State taxes and nexus: It’s more than physical!

Deeper dive on sales/use taxes
- This is easy, right?

Patterns with states’ "economic nexus" sales/use tax laws
- Economic nexus thresholds and start dates
- Open issues after **Wayfair**

Practical impact to businesses
- Action plan!

Managing sales tax determination
- Automation is your friend

Q&A
The Wayfair Decision
**South Dakota v. Wayfair**

- On June 21, 2018, the U.S. Supreme Court held that states may require a retailer to collect and remit sales tax even if the retailer lacks an in-state physical presence.
- The Court overruled the long-standing “bright-line physical presence” test.

The U.S. Supreme Court gave a “nod” to South Dakota’s economic nexus provisions that were prospective only.
South Dakota: The Sales Tax Imposition Statute

On March 22, 2016, the South Dakota governor signed into law a bill effective May 1, 2016, that required remote sellers to remit sales tax on all taxable sales if, in the previous calendar year or the current calendar year:

1. The seller’s gross revenue from the sale of TPP, any product transferred electronically, or services delivered into SD exceeds $100,000; or
2. The seller sold TPP, any product transferred electronically, or services for delivery into SD in 200 or more separate transactions.

The law stated: “No obligation to remit the sales tax required by this Act may be applied retroactively.”
Deeper Dive On Sales/Use Taxes
Individuals’ “use tax” compliance is generally dismal.

Individuals generally don’t maintain appropriate records to comply and revenue departments seldom conduct audits.

U.S. Sales/Use Tax Overview

- 45 states & DC impose sales taxes on retail sales (not wholesale sales) of tangible personal property (“TPP”) and enumerated services.
- Sales taxes are generally destination based.
- Every state that imposes a “sales tax” also imposes a complementary “use tax.”
- Local sales/use taxes:
  - None (CT)
  - The only sales/use tax (AK)
  - State administered (SD)
  - Locally administered (LA)
States’ Power To Tax

States’ power to impose sales/use taxes is limited by:

► State law
  • Sales tax statutes, regulations, cases
  • State constitutions

► Federal law
  • U.S. Constitution
    - Due Process Clause
    - Commerce Clause
    - First Amendment
  • Federal statutes
    - Internet Tax Freedom Act
Prior to Wayfair, businesses understood that states could not require a retailer to administer sales/use taxes if:

- The retailer had no in-state physical presence
  - No office
  - No employees
  - No sales representative (including third-party)
  - No property, including consigned inventory

- The retailer had an in-state physical presence, but the presence did not create a “substantial nexus” with the state.
  - Floppy disks
Getting Around the “Physical Presence” Tax Barrier

Despite *Bellas Hess & Quill*, states continued to assert taxing power:

- **Affiliate nexus** — If the remote retailer has an affiliate with an in-state physical presence, the affiliate’s nexus may be attributed to the retailer.

- **Click-through nexus** — If an in-state person directly or indirectly refers potential customers to the retailer for a commission or other consideration, the retailer is treated as having nexus in the state.

- **Cookie nexus** — Assertion of “physical presence” due to “cookies” being placed on prospective or current customer’s computer.

- **Marketplace nexus** — Deems a marketplace facilitator as the seller who is required to administer sales tax on any taxable sale.

- **Use tax notice & reporting** — Requires out-of-state sellers to notify customers that they must pay use tax on their purchases and report all purchases to the state.
Affiliate Nexus

EXAMPLE: OKLAHOMA

H.B. 2531 (eff. Nov. 1, 2016)

- Created a rebuttable presumption that a vendor has is required to collect Oklahoma sales/use tax if it has a subsidiary in the state that:
  - Sells a similar line of products, and does so under the same/similar business name,
  - Uses trademarks, service marks, or trade names that are the same/substantially similar to those used by the vendor,
  - Delivers, installs, assembles, or performs maintenance services for the vendor, or
  - Facilitates delivery of the vendor’s products.

- Nexus presumption can be rebutted by demonstrating that:
  - The subsidiary’s activities in the state are not significantly associated with the vendor’s ability to establish and maintain a market in the state for the vendor’s sales.
Remote Internet sellers are presumed required to collect NY sales/use tax if:

- they enter into agreements with NY residents for a commission for referring potential customers, either directly or indirectly, and
- Derive gross receipts > $10,000 over a 12-month period from such referrals.

Presumption rebuttal:

- If the retailer can establish that the only activity of its NY resident representatives on the retailer’s behalf is a link on the representative’s website AND
- none of the resident representatives engage in any solicitation activity in NY targeted at potential NY customers on the seller’s behalf.

Amazon’s response:

- In states where Amazon wasn’t registered, it severed relationships with affiliate online sellers located in states with click-through nexus.
## Current State Click-Through Nexus

<table>
<thead>
<tr>
<th>State</th>
<th>Effective Date</th>
<th>Annual Threshold (before required to file)</th>
<th>Statute</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arkansas</td>
<td>October 24, 2011</td>
<td>$10,000</td>
<td>Ark. Code Ann. Sec. 26-52-117</td>
</tr>
<tr>
<td>California</td>
<td>September 15, 2012</td>
<td>$10,000 and seller has more than $1,000,000 in CA sales</td>
<td>CA Sec. 6203 of Rev &amp; Tax Code</td>
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<td>Georgia</td>
<td>December 30, 2012</td>
<td>$50,000</td>
<td>GA. CODE ANN. § 48,8,2(8)(K)</td>
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<tr>
<td>Idaho</td>
<td>July 1, 2018</td>
<td>$10,000</td>
<td>H.B. 578 (enacted 3/21/2018)</td>
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<tr>
<td>Illinois</td>
<td>July 1, 2011</td>
<td>$10,000 from prior year</td>
<td>35 ILCS 105/2 and 110/2</td>
</tr>
<tr>
<td>Iowa</td>
<td>January 1, 2019</td>
<td>$10,000 from current or prior year</td>
<td>S.F. 2417 (enacted 6/12/2018)</td>
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<tr>
<td>Louisiana</td>
<td>April 1, 2016</td>
<td>$50,000 from prior 12 months</td>
<td>La. R.S. section 47:302.V.</td>
</tr>
</tbody>
</table>
## Current State Click-Through Nexus

<table>
<thead>
<tr>
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<th>Effective Date</th>
<th>Annual Threshold (before required to file)</th>
<th>Statute</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minnesota</td>
<td>July 1, 2013</td>
<td>$10,000</td>
<td>Minn. Stat. § 297A.66(4a)</td>
</tr>
<tr>
<td>Missouri</td>
<td>August 28, 2013</td>
<td>$10,000</td>
<td>Mo. Rev. Stat. § 144.605</td>
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<td>New Jersey</td>
<td>July 1, 2014</td>
<td>$10,000</td>
<td>N.J. Stat. §54:32B-2(i)</td>
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<tr>
<td>Nevada</td>
<td>October 1, 2015</td>
<td>$10,000</td>
<td>2015 Nev. A.B. 380</td>
</tr>
<tr>
<td>New York</td>
<td>June 1, 2008</td>
<td>$10,000</td>
<td>N.Y. Tax Law Sec. 1101(b)(8)(vi)</td>
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<tr>
<td>North Carolina</td>
<td>August 7, 2009</td>
<td>$10,000</td>
<td>N.C. Gen. Stat. Sec. 105-164.8</td>
</tr>
<tr>
<td>Ohio</td>
<td>July 1, 2015</td>
<td>$10,000</td>
<td>Sec. 5741.01(I)(2)(g)</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>July 1, 2009</td>
<td>$5,000</td>
<td>R.I. Gen. Laws Sec. 44-18-15</td>
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<tr>
<td>Tennessee</td>
<td>July 1, 2015</td>
<td>$10,000</td>
<td>2015 Tenn. H.B. 644</td>
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<tr>
<td>Washington</td>
<td>September 1, 2015</td>
<td>$10,000</td>
<td>Sec. 202(1)</td>
</tr>
</tbody>
</table>
Cookie Nexus

EXAMPLE: MASSACHUSETTS

Regulation 830 CMR 64H.1.7 (eff. 9/22/17)

A remote Internet vendor is required to collect and remit sales tax if, during the prior calendar year, it had:

• “property interests in and/or the use of in-state software (e.g., “apps”) and ancillary data (e.g., “cookies”) which are distributed to or stored in the computers or other physical communications devices of a vendor’s in-state customers, and may enable the vendor’s use of such physical devices;
• over $500,000 in MA sales over the Internet; and
• 100 or more deliveries in MA from those sales.

Court challenge:

• Crutchfield Corp. filed its lawsuit in Virginia (not MA)!
• Asserted a violation of federal statutes & constitutional law
• 6/22/18: MA issued a press release: Regulation remains in effect
Marketplace Facilitator Nexus

EXAMPLE: PENNSYLVANIA


- Requires a “marketplace facilitator” to collect and remit PA sales/use tax on sales of TPP if it delivered into PA within a 12-month period sales worth **at least $10,000** during the prior 12 months.
  - Exception: if the marketplace facilitator elected to comply with use tax notice and reporting requirements (discussed next).

- **A “marketplace facilitator”:**
  - Lists or advertises TPP for sales at retail in any forum; and
  -Either directly or indirectly through agreements or arrangements with third parties, collects the payment from the purchaser and transmits the payment to the person selling the property.

- **Amazon:**
  - Automatically calculates, collects, and remits sales tax on behalf of sellers for orders shipped to customers in PA, WA, and OK.
Use Tax Notice & Reporting Laws

EXAMPLE: COLORADO (ENFORCEMENT STARTED 7/1/17)

- Requires out-of-state, non-registered retailers with Colorado sales in excess of $100,000 to provide:
  - a transactional notice to all CO purchasers at the time of purchase;
  - an annual purchase summary to all CO purchasers by Jan. 31; and
  - an annual customer information report to the Department by March 1.

- Non-compliance penalties:
  - Transactional notice penalty: $5 for each sale
  - Annual purchase summary penalty: $10 for each failure
  - Annual customer information report penalty: $10 for each purchaser excluded

- Other states that enacted notice & reporting laws
  - AL, GA, IA, KY, LA, OK, PA, RI, SD, TN, VT, WA
Use Tax Notification & Reporting Laws

- Colorado’s penalty regime is typical. But, watch out!
- Pennsylvania and Washington are especially punitive.
  - PA - Annual penalty of lower of $20,000 or 20% of total PA sales.
  - WA -
    - (1) $20,000 for failure to provide transaction notice to customers;
    - (2) $20,000 minimum, or $25 per customer, for failure to provide sales report to the Department; AND
    - (3) a tiered penalty structure for failure to provide annual report to customers as follows:

<table>
<thead>
<tr>
<th>Annual WA Gross Receipts</th>
<th>Penalty Amount</th>
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<tbody>
<tr>
<td>Under $50,000</td>
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<td>Under $150,000</td>
<td>$10,000</td>
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<tr>
<td>Under $300,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>$300,000 and above</td>
<td>$100,000 + $20,000 per $50,000 of additional gross receipts</td>
</tr>
</tbody>
</table>
Litigation: Use Tax Notification/Reporting Set The Stage For Wayfair

**Direct Marketing Ass’n v. Brohl, (US 2015)**
- Justice Kennedy indicated: It’s time to reconsider *Quill’s* physical presence standard.
  - “There is a powerful case to be made that a retailer doing extensive business within a State has a sufficiently ‘substantial nexus’ to justify imposing some minor tax-collection duty, even if that business is done through the mail or the Internet... This argument has grown stronger and the cause more urgent with time.”

The U.S. Supreme Court held that the case could be decided by a federal court.

On remand, in 2016, the 10th Circuit held that *Quill* did not apply and Colorado’s notice and reporting law was permissible.
## Summary of Sales/Use Tax Nexus Rules

<table>
<thead>
<tr>
<th>State</th>
<th>Click-Through Nexus</th>
<th>Affiliate Nexus</th>
<th>Reporting Requirements</th>
<th>Economic Nexus</th>
<th>Marketplace Nexus</th>
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<td>Alabama</td>
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<td>New Jersey</td>
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<td>North Dakota</td>
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<td>Texas</td>
<td>7/1/2012</td>
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<td>Vermont</td>
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<td>Effective date pending SD legislation</td>
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<td>Washington</td>
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<td>Wyoming</td>
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Patterns With States’ “Economic Nexus” Sales/Use Tax Laws
Wayfair & “Economic Nexus”

- The Court’s “nod” to South Dakota’s statute:
  - Safe harbor to those with limited business in South Dakota:
    - $100,000 sales or 200 separate transactions
  - NOT retroactive
  - Standardized sales/use tax laws that reduce administration & compliance costs

- Wayfair case isn’t over!
  - “Question remains whether some other principle in the Court’s Commerce Clause doctrine might invalidate [South Dakota’s tax law].”
States with Sales/Use Tax Economic Nexus Statutes
(AS OF 8/3/2018)

www.bdo.com/wayfair

Enacted statute/rule
Proposed in 2018
Enforcement suspended
Statute/Rule not enacted to date*

*AK, DE, MT, NH, OR have no sales/use tax

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HOW TO DEAL WITH THE IMPACTS OF WAYFAIR
Safe Harbor: Not Consistent Everywhere

- Some states’ laws require greater (or lesser) contacts that SD requires:
  - And vs. Or
    - “Or” -- SD is an “or” state: $100,000 sales OR 200 transactions
    - “And” -- CT & MA laws say “and”
  - Sales thresholds
    - $100,000 sales: SD and most other states
    - > $100,000:
      - AL, CT, GA, MS ($250,000)
      - MA, TN ($500,000)
    - < $100,000: OK, PA ($10,000)
  - No safe harbor
    - “Sleeper laws” (MD, SC)
Start Dates: Not Consistent!!

- **Retroactivity concerns:**
  - ME, MD, MA, MS, OH, PA, RI, SC, WA, WY
- **6/21/18:**
  - LA, ND
- **7/1/18:**
  - HI, VT
- **10/1/18:**
  - AL, IL, IN, KY, MN, NJ, WI
- **12/1/18:**
  - CT
- **1/1/19:**
  - GA, IA, UT
Standardized Sales/Use Tax Laws

South Dakota is party to the Streamlined Sales and Use Tax Agreement
- SD is one of over 20 states
- See www.streamlinedsalestax.org

Key features of the Streamlined Sales Tax:
- Uniform definitions
- Tax rate simplification
- Uniformity of state/local tax bases
- State-level tax administration
- Uniform sourcing rules
- Uniform administration of exempt sales
- Single online central registration system
- Simplified and uniform tax returns and tax remittance procedures
- State funding of the system
Practical Impact To Businesses
BDO’s Perspective
THE WHOS, WHATS, WHYS, AND HOWS...

- Businesses impacted
- Tax types impacted
- Impact on financial reporting
- Risks of taking no action
- Recommended action steps
All industries are likely to see an impact from the Wayfair decision, but these are likely the most widely impacted.

**Businesses Impacted**

- **Retail and Consumer Products**
  - e-Commerce
  - Service providers

- **Technology**
  - Online services (SaaS, sellers of digital products)

- **Private Equity/M&A**
  - PE firms and strategic buyers will need to address Wayfair exposure and ongoing compliance requirements of their portfolio companies and targets

- **Non-U.S. Businesses**
  - U.S. tax treaties generally do not apply at the state level
  - A foreign business with no U.S. permanent establishment may still be subject to state economic nexus provisions
Tax Types Impacted

- Sales/use taxes
- Gross receipts taxes
- Non-net income taxes
- State income taxes
  - Caveat: Public Law 86-272 still applies!
Sales Tax Remediation

FAS 5 / ASC 450-20 CONSIDERATIONS

- FAS 5 / ASC 450-20 provides that an estimated loss from a loss contingency must be accrued as a charge to income if both of the following conditions are met:
  • Information indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements; and
  • The amount of loss can be reasonably estimated.

- Accrue the best estimate in a range or lowest amount in the range.

- When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote:
  • Probable - The future event or events are likely to occur
  • Reasonably Possible - The chance of the future event or events occurring is more than remote but less than likely
  • Remote - The chance of the future event or events occurring is slight
Risks of Taking No Action

► Financial risks:
  • Sales tax: Detection risk by departments of revenue
  • Use tax notification penalties
  • Qui Tam lawsuits: Detection risk by non-government persons
  • Class action lawsuits: Complying - but not properly - resulting in overcharging tax
  • Other tax types, too!

► Reputational risks

► Regulatory risks
Sales Tax Remediation

FIVE STEP APPROACH

1. Nexus Discussion
2. Taxability Based On Revenue Streams
3. Exposure Quantification
4. Mitigation and Disclosure
5. Sales Tax Compliance
Sales Tax Remediation
FIVE STEP APPROACH (CONT’D)

► Step 1 - Determine Nexus and Filing Obligations
  • Determine where the company may have nexus
  • Determine where the company has a filing obligation

► Step 2 - Determine the Taxability of Products and Services
  • Evaluate the Company’s revenue streams to determine the taxability
  • Evaluate the Company’s customer base for possible exemptions

► Step 3 - Quantify Potential State Tax Exposure
  • Compile sales tax data
  • Destination based sourcing
  • State & Local Tax, Interest & Penalty Rates
  • Compute Exposure Amount
Sales Tax Remediation
FIVE STEP APPROACH (CONT’D)

► Step 4 - Mitigation and Disclosure of Historical Liabilities
  • Filing and Paying All Prior Tax Returns
  • Voluntary Disclosure - Anonymous basis
  • Negotiated Settlement
  • Do Nothing

► Step 5 - Prospective Compliance
  • Indirect Tax Automation
  • Utilization of rate software
  • In-house or outsource tax return function
Managing Sales Tax Determination and Reporting
What Are My Options?

Tax Determination
- Maintain Existing Process at Larger Capacity
- Acquire a Tax Rate Subscription
- Acquire a Third-Party Tax Determination Software

Tax Compliance Reporting
- Maintain Existing Process at Larger Capacity
- Acquire a Third-Party Tax Reporting Software
- Outsource Tax Reporting
### Advantages/Challenges of Options

#### MAINTAIN EXISTING PROCESS

#### Tax Determination

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>No cash outlay for rate subscription or tax software</td>
<td>Manual maintenance of tax rates</td>
</tr>
<tr>
<td></td>
<td>Customization for special tax calculation rules</td>
</tr>
<tr>
<td></td>
<td>Manual maintenance of taxability research</td>
</tr>
</tbody>
</table>

#### Tax Compliance Reporting

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>No cash outlay for tax software or outsourcing</td>
<td>Increase in number of tax return filings</td>
</tr>
<tr>
<td></td>
<td>Potential need to hire additional resources</td>
</tr>
</tbody>
</table>
## Advantages/Challenges of Options

### ACQUIRE TAX RATE SUBSCRIPTION

### Tax Determination

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>No cash outlay for tax determination software</td>
<td>Customization for special tax calculation rules</td>
</tr>
<tr>
<td>No manual maintenance of tax rates</td>
<td>Manual maintenance of taxability research</td>
</tr>
</tbody>
</table>
Advantages/Challenges of Options

ACQUIRE THIRD-PARTY TAX DETERMINATION SOFTWARE

Tax Determination

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>No manual maintenance of tax rates</td>
<td>Investment in tax determination software</td>
</tr>
<tr>
<td>Taxability content provided *</td>
<td>Investment in set-up and testing</td>
</tr>
<tr>
<td>State and local tax authorities provided</td>
<td>Configuration maintenance</td>
</tr>
<tr>
<td>Source for tax compliance reporting</td>
<td></td>
</tr>
<tr>
<td>Manage customer exemptions/exceptions</td>
<td></td>
</tr>
<tr>
<td>Manage product/service exceptions</td>
<td></td>
</tr>
<tr>
<td>Manage jurisdictional exceptions</td>
<td></td>
</tr>
<tr>
<td>Source for audit support</td>
<td></td>
</tr>
<tr>
<td>Resource re-deployment</td>
<td></td>
</tr>
</tbody>
</table>

* (Most but not all products and services)
Advantages/Challenges of Options

ACQUIRE THIRD-PARTY TAX REPORTING SOFTWARE

Tax Compliance Reporting

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Can produce signature-ready tax returns</td>
<td>Investment in tax reporting software</td>
</tr>
<tr>
<td>Reduces tax return preparation effort</td>
<td>Web site filings are still necessary</td>
</tr>
</tbody>
</table>

EDI Filing Options
## Advantages/Challenges of Options

### OUTSOURCE TAX COMPLIANCE REPORTING

### Tax Compliance Reporting

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>No cash outlay for tax reporting software</td>
<td>Cost of outsourcing</td>
</tr>
<tr>
<td>Resource re-deployment</td>
<td></td>
</tr>
</tbody>
</table>
Tax Vendors

Tax Determination Software
- Vertex
- Thomson Reuters (Sabrix)
- Avalara
- SOVOS (Taxware)
- CCH

Tax Rate Subscriptions
- Zip2Tax
- Thomson Reuters
- Vertex
- CCH
Cost Considerations

- Cost to Maintain Existing Process
  - Internal EFT’s

- Tax Rate File Subscription
  - $3K - $15k +

- Cost of Third-Party Tax Determination Software
  - Depends on your needs
  - $5K - $150K +

- Cost of Third-Party Tax Reporting Software
  - $8k - $40k

- Cost of Outsourcing
  - $30 - $50 + (Per Return)
  - Add-on costs depending on service provider
Automation with Third-Party Software:  
INVESTMENT SCOPE

- Software licensing
  - Initial license fee - First Year
  - Annual support renewal - Second Year +
- Software connector
  - Service fee for establishing communication with ERP
- Implementation
  - Professional Service provider fees covering project lifecycle
- Internal (EFT’s) Resources
  - Project assistance and upkeep after Go-Live
Automation with Third-Party Software:
COMMON PROJECT LIFECYCLE

- ID Service Provider
- Diagnostic Review
- ID Tax S/W Vendors
- Schedule Demos
- Award Vendor Contract

- Gather details
- Determine GAPS
- Review Master Data

- Develop Blue Print
- Prepare Environments
- Install Software
- Prep config load

- Configure Tax S/W
- Unit test Config
- Resolve Issues

- Integration testing
- System testing
- Resolve Issues

- Knowledge Transfer
- Monitor Solution

Ramp Up
Planning & Requirements
Design
Configuration
Testing
Training & Production Monitoring

June 2018 - Sep 2018
Automation with Third-Party Software:
COMMON DELIVERABLES

- Project work plan
- Roles & responsibilities matrix
- Business requirements & Gap analysis
- Functional design document
- Tax configuration guide
- Test plan & results
- Training materials
Automation with Third-Party Software:

AUTOMATION PROJECT RESOURCES

Company
• Tax representative(s)
• Accounts receivable & billing
• Procurement & accounts payable
• Information Technology (DBA, Network Engineer)

Service Provider
• Project team (Director, Manager, Staff Associate)
• Multi-State professionals & Tax Software Expertise

Tax Software Vendor
• Software technical consultant
• Professional Services coordinator
Automation with Third-Party Software: EXAMPLE TOPOLOGY

Financial System:
- eCommerce
- Navision
- Netsuite
- SAP
- Oracle
- Peoplesoft
- Homegrown

Sales Invoice Detail

Tax Determination Software:
- Tax Rates
- Tax Geographies
- Taxability Content
- Customer Exceptions
- Product Exceptions
- Custom Rules
- Compliance/Audit Reporting

Tax Results
Thank you!
Questions?

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- Greg Rosser - grosser@bdo.com / 713-548-0902
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