BDO KNOWS:

BDO KNOWS SALT

CONTACT

ROCKY CUMMINGS
Practice Leader
415-490-3130
rcummings@bdo.com

STEVE OLDROYD
Managing Director
408-352-1994
soldroyd@bdo.com

DAVID WINKLER
Senior Manager
414-272-4337
dwinkler@bdo.com

MARIANO SORI
Partner
312-616-4654
msori@bdo.com

ERIC FADER
Managing Director
312-730-1432
efader@bdo.com

SOUTH DAKOTA V. WAYFAIR UNLEASHES THE ONLINE SALES TAX DEBATE

The *South Dakota v. Wayfair, Inc.* case may mark a monumental development in the debate over the digital economy's responsibility for the collection of sales tax. As companies increasingly conduct business across state lines, how states and the federal government craft tax legislation that addresses the evolution of 'nexus' could have significant implications for e-commerce, digital services providers, and taxpayers alike.

The U.S. Supreme Court's review of the current nexus standards at issue in *South Dakota v. Wayfair, Inc.*, could result in the Court overturning *Quill Corp. v. North Dakota*, which established the physical presence nexus standard that presently applies to sales tax. The current physical presence nexus standard severely limits states' abilities to impose such a tax on an out-of-state seller. In December 2017, the U.S. Government Accountability Office estimated that state and local governments lost between $8 billion-$13 billion in revenue in 2017 because they did not have the authority to require sales tax collection from all remote sellers and because purchasers commonly fail to self-assess and remit use taxes. In addition to lost sales tax revenues, states are also losing income tax revenues because states typically impose income taxes on businesses with an in-state physical presence.

With this case, South Dakota has asked the Court to decide whether the physical presence standard is outdated, and whether states can constitutionally require out-of-state retailers to charge and collect sales and use taxes from in-state consumers when the retailer has no physical presence within a state. To date, over a dozen states, including South Dakota, have created economic nexus legislation for out-of-state sellers, despite a lack of authorization from Congress or the High Court. Moreover, about a dozen states impose economic nexus standards for state income tax purposes.

When the case was recently argued before the Supreme Court, Justices across party lines appeared divided. Many questioned the potential impact of retroactive applications, the cost burdens for businesses should they be required to collect sales and use taxes, and whether a signal from the Court for congressional action was the better course of action.

While companies will have to wait patiently for clarity from either the Supreme Court or Congress, they should take the time now to better understand their business connections across states. After all, both retailers of tangible products and digital services providers stand to face major repercussions if the nexus standard is altered. While some large online retailers have already begun collecting sales taxes, changes to nexus standards could disrupt the balance between online retail and brick-and-mortar retail. Digital service providers would also be charged with the complex task of understanding how their various services are taxed (or not) across state lines.

HOW COMPANIES CAN PREPARE FOR A NEW NEXUS STANDARD:

1. Communicate to internal and external stakeholders (e.g., CFO, Legal, Sourcing, IT, Customer Support, A/R, A/P, and customers) the potential for a new national nexus standard for sales tax and potentially state income tax.

2. Maintain or invest in a system that tracks how products and services are sold throughout different states.

3. Understand how products or services will be taxed in all the states and localities that impose a sales and use tax. If Quill is overturned, there could be over 10,000 different sales and use tax rates throughout the nation to administer.

4. Maintain or invest in an accounting or billing system that can handle the reporting requirements for all the states and localities in which the company conducts business.

5. Identify which potential sales & use and state income tax liabilities the company may be exposed for, including both past and present liabilities, and quantify the same. Consider mitigating historical exposures through voluntary disclosure agreements. This will be particularly relevant in the mergers and acquisitions arena.

Below, we've outlined the potential implications of either outcome to the online sales tax debate:

Stakeholders	If the Physical Nexus Standard Remains Intact…	If the Physical Nexus Standard is Overturned…
States	States may expand their nexus standards based on whatever guidance is provided by the Supreme Court in the *Wayfair* decision, such as by adding affiliate or click-through nexus, "cookie" nexus, and marketplace facilitator sales taxes. States also may create seller notice and reporting requirements along the lines of those previously enacted by Colorado. States will also presumably increase their pressure on Congress to create a national nexus standard to increase the percentage of online sales subject to sales tax.	States will be encouraged to enact sales and use tax economic nexus legislation such as that enacted by South Dakota. Many expect a period of chaos will ensue during the time it takes for states to determine their respective sales and use tax collection responsibilities relating to remote sellers. States will also be encouraged to enact state income tax economic nexus provisions. About a dozen states already have economic nexus provisions for state income tax purposes.

▶ Read more

Stakeholders	If the Physical Nexus Standard Remains Intact…	If the Physical Nexus Standard is Overturned…
E-Commerce	Remote sellers (i.e. pure e-commerce companies, retailers with online stores, third-party online vendors, or any other out of state retailer that directs sales and/or deliveries into a state) will need to address any new nexus standards and/or notice and reporting requirements enacted by states.	Remote sellers will be required to register and collect sales and use tax in all the states and localities where they have sales that satisfy the economic nexus standards. Sellers could have exposure for past periods in at least some states, meaning they will have to remit sales taxes retroactively even if uncollected from the consumer. Remote sellers will also need to pay state income taxes in states where they meet the economic nexus standards.
Digital Service Providers	Today, 26 states impose sales tax on digital products, 16 states impose tax on software-as-a-service solutions, and 12 states impose tax on information services. These numbers presumably will continue to increase over time.	Digital service providers will be impacted similarly to other e-commerce companies but may face additional sourcing challenges related to determining in which taxing jurisdiction the customer received the digital good or service.
Consumers	No significant changes.	Consumers, except those currently self-assessing use tax on their online purchases, will pay additional taxes on these purchases. Fifty-one percent of online shoppers consider the sales tax before making a purchase, according to the latest **BDO Consumer Beat Survey.**
Buyers and Sellers of Businesses	The Supreme Court's decision in *Wayfair* could change or further refine nexus standards, making the determination of nexus more or less difficult to estimate and negotiate by deal makers.	Buyers may be more reluctant to assume nexus risk in states where the Quill decision had previously provided some protection. Buyers may also need to factor into their investment decisions the administrative burden and compliance costs that will result from having to file in more jurisdictions.