INSIGHTS FROM THE BDO MANUFACTURING & DISTRIBUTION PRACTICE

MANUFACTURERS AREN'T IMMUNE FROM *WAYFAIR'S* SALES TAX IMPACT

BACKGROUND ON *SOUTH DAKOTA VS. WAYFAIR*

Earlier this summer, the U.S. Supreme Court ruled in the landmark case *South Dakota vs. Wayfair* that the "physical presence test" for determining if a seller is required to administer sales taxes is "incorrect." States may now legally require sellers to administer sales taxes, even if the seller has no in-state physical presence.

The case is a momentous 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 evolving definition of "nexus" significantly impacts all taxpayers—including manufacturers.

While many states offer manufacturers generous sales tax exemptions on certain equipment and machinery purchases, the industry is now faced with new sales/use tax rules that impact both purchase and sale transactions. The *Wayfair* decision has important business implications manufacturers can't afford to ignore—lest they wind up with a hefty tax bill they didn't plan for.

INCREASED ADMINISTRATIVE INVESTMENT

The most immediate and obvious impact of *Wayfair* for manufacturers will be increased reporting and compliance requirements on sale transactions, especially related to obtaining resale exemption certificates from customers located in states where manufacturers have no in-state presence. In addition to exemption certificates, manufacturers may now need to register and file sales tax returns in certain states where they ship or deliver goods, even if they do not have a physical presence there.

As a starting point, manufacturers need to reassess their sales tax collection compliance based on each state's specific economic nexus standard. Manufacturers may also need to add resources to ensure tax exemption certificates are successfully received, validated and retained in all relevant states. Since states have unique application processes and varying exemption expiration dates, some companies may find it helpful to engage external advisors with state-specific expertise.

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To claim sales tax exemptions on their own purchases, including raw materials, manufacturers must apply for and obtain exemption certificates. Prior to *Wayfair*, manufacturers only needed to provide these certificates to suppliers that had a physical presence in the state where the manufacturer had operations. Now, however, manufacturers may need to issue sales tax exemption certificates to all their suppliers, regardless of where they conduct business.

Manufacturers should confirm their internal controls and reporting systems are robust enough to operate smoothly in a post-*Wayfair* world. Many companies may consider developing automated systems to track their in-state commerce efficiently across numerous state and local jurisdictions, all while managing the myriad and often changing exemptions and different states' product and service taxability definitions.

With the "physical presence" nexus standard no longer the law of the land, states are using sales volume and transaction activity—or number of invoices—as measures for nexus. Sellers need to monitor their economic nexus, in addition to their physical presence, for tax nexus purposes.

However, states are not applying uniform nexus thresholds. For example, while California is introducing a $500,000 economic nexus threshold, Indiana's nexus threshold is $100,000. Manufacturers need to remain vigilant, since economic nexus thresholds vary between states and new guidance or rules may continue to be released.

EXCEPTION TO THE EXEMPTION RULE

Perhaps contrary to popular belief, not everything manufacturers purchase is exempt from sales tax. Office supplies, hand tools, disposable products, and even certain machinery or equipment are often subject to sales tax. Manufacturers may find that their suppliers are now starting to charge sales tax in light of *Wayfair*. Manufacturers should monitor their supply chains so they don't also, in error, pay sales tax on exempt purchases like raw materials. More now than ever, manufacturers should pay close attention to the invoices received from their suppliers to confirm that they are not paying sales taxes in error (as well as to self-assess use tax, as appropriate).

Major changes in tax laws—like *Wayfair*—cause ripple effects that have impacts far beyond just the accounting department. Supply chain, long-term growth strategies and even dealmaking decisions are all areas potentially impacted by changes in tax. A deep understanding of *Wayfair*, as well as continuous monitoring of related, state-specific changes, is vital to adapting quickly and effectively to new rules and their impacts. While *Wayfair* is a closed case before the U.S. Supreme Court, the decision will continue to make waves for manufacturers for years to come.

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