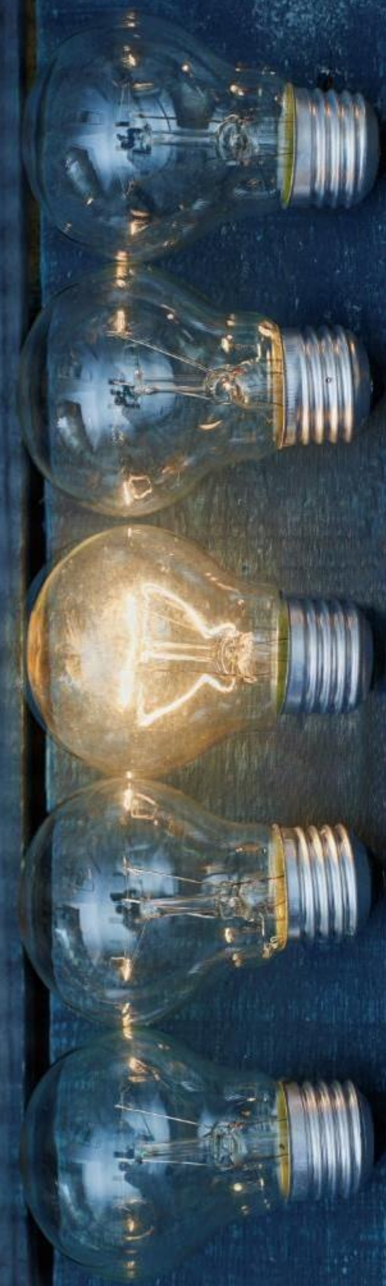
KPMG Share Forum

The *Wayfair* decision: navigating a world without *Quill*



Los Angeles, CA

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Wayfair: The Case and What it Means

Agenda

- Introduction
- *South Dakota v. Wayfair* and highlights from the decision
- Where do we go from here?
  - Use tax notice and reporting requirements
  - Marketplace provider obligations
  - Next steps

Quill – and how we got here

In *Quill v. North Dakota* (1992), the U.S. Supreme Court ruled that a state cannot require a business to collect use tax from in-state customers if the business has no physical presence in the state

— In the 26 years since *Quill* was decided, states have been increasingly aggressive in their efforts to narrow *Quill's* effect and expand what constitutes a physical presence

  - Initial efforts focused on representational nexus – states asserting that the physical presence of a third-party or an affiliate in the state created nexus for the out-of-state seller
  - This required a showing that the in-state person was engaging in activities that were "significantly associated with the seller's ability to establish and maintain a market for sales"

— Most recently, several states have adopted "economic nexus" standards that require sellers with no physical presence to collect sales and use tax if they exceed certain bright-line sales or transaction thresholds

  - Many of these state statutes specifically acknowledged that the economic nexus standards and thresholds conflicted with the Court's holding in *Quill*

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South Dakota v. Wayfair

Background

— In 2016, South Dakota passed Senate Bill 106, which adopted an economic nexus standard for sales and use tax purposes

- Under the revised law, any seller with sales exceeding an annual threshold of $100,000 or 200 separate transactions in South Dakota was required to collect and remit effective May 1, 2016
- The law was quickly challenged; as was expected

— On September 14, 2017, the South Dakota Supreme Court held that the state is bound to follow established U.S. Supreme Court precedent

- A law imposing economic nexus standards on remote retailers could not be enforced in light of *Quill*

On January 12, 2018, the U.S. Supreme Court granted certiorari and oral arguments were held April 17, 2018

South Dakota v. Wayfair

On June 21, 2018, the Court ruled in a 5-4 decision in favor of South Dakota

— The Court concluded that the physical presence rule set forth in *Quill* is overruled as it is "unsound and incorrect"

— The physical presence rule "has been the target of criticism over many years from many quarters"

  - "*Quill* is flawed on its own terms. First, the physical presence rule is not a necessary interpretation of the requirement that a state tax must be applied to an activity with a substantial nexus with the taxing state. Second, *Quill* creates rather than resolves market distortions. Third, *Quill* imposes the sort of arbitrary, formalistic distinction that the Court's modern Commerce Clause precedents disavow"

— While multistate business may be faced with significant compliance costs, the Court suggested that other aspects of constitutional analysis, can "better and more accurately address any potential burdens on interstate commerce"

— The four dissenters followed varied lines of reasoning, including decrying the lack of a record and that the issue was better left to Congress; none defended the physical presence rule

What are the implications for sellers?

The physical presence rule has been overturned, but it is not clear how the Court's holding will be applied in every other state

— It's important to keep in mind that the Court did not hold that South Dakota's law would be permissible under every circumstance in every state
  - The Court held that the taxpayers at issue had the requisite virtual and economic contacts with South Dakota to meet the "substantial nexus" requirement
    — There might be a different result for different sellers in other states

— Also, under the Court's rationale, the laws, as applied to the sellers, ***cannot discriminate or place undue burdens on interstate commerce***
  - The South Dakota statute, in the Court's view, appeared to do neither
    — The South Dakota law included a safe harbor for those sellers who transacted only limited business in South Dakota; ensured that no obligation to remit the sales tax may be applied retroactively; and, South Dakota is one of more than 20 States that have adopted the Streamlined Sales and Use Tax Agreement

What are the implications for sellers?

Immediate considerations

— A number of states have laws similar or substantially similar to South Dakota's
  - The effective dates of these laws varies by state and they must be reviewed carefully
    — In certain states, the state is enjoined from enforcing the laws until litigation is resolved and the laws can be applied prospectively only
    — In other states that's not explicit and it's unclear how states will act going forward
    — No state has to this point established a retroactive effective date

— There are many other states that have no economic nexus rules – at least currently – but their doing business statutes may be sufficiently broad so as to encompass remote selling and/or they do not specifically require a physical presence

— States have begun to issues guidance and establish dates by which they expect affected sellers to register and begin collecting
  - Sellers will need to carefully track state responses and act accordingly

Wayfair – Categorization of States

The following slide groups states with respect to adopting economic nexus standards (i.e., sales and/or transaction-based thresholds) governing sales/use tax collection and the implementation thereof

— Quadrant A – States with an adopted standard (statute or rule) and an announced implementation date. (Note WI has announced it will propose rule with 10/1/2018 date.)

— Quadrant B – States with an adopted standard that are enjoined from implementation until state litigation is resolved or that have issued no specific guidance post-*Wayfair* regarding a date for implementation

— Quadrant C – States in which the “doing business” statute is sufficiently broad to encompass economic nexus, but have not announced the manner or date on which they intend to begin requiring collection

— Quadrant D – States with a “collect or report” option for sellers that exceed the established threshold, and MA and OH, which have economic nexus standard, but also require an affected seller to have contacts not traditionally viewed as involving a physical presence (e.g., using software in the state) before collection may be required required

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Reactions to *Wayfair* – 08/15/2018

A. Economic nexus with effective date

AL – 10/1/2018 CT – 12/1/2018 (lower threshold pre-12/1/2018) HI – 7/1/2018 IL – 10/1/2018 IA – 1/1/2019	LA – 1/1/2019 KY – 10/1/2018 ME – 7/1/2018 MD – 10/1/2018 (proposed rule) MI – 10/1/2018	MN – 10/1/2018 MS – 9/1/2018 NE – 1/1/2019 NJ – 10/1/2018 NC – 11/1/2018	ND – 10/1/2018 UT – 1/1/2019 VT – 7/1/2018 WA – 10/1/2018 WI – 10/1/2018

B. Economic nexus with no specific date

IN (enjoined) NV (proposed rule, TBD)	SD (enjoined)	TN (enjoined; needs legislative approval)	WY (enjoined)

C. Broad doing business statute*

*Statute likely broad enough so as not to require physical presence, but no official notice/action taken requiring collection by remote sellers

AZ AR CA	DC FL ID	KS MO	NM NY	SC TX	VA WV

D. Other

CO (collect-or-report) GA (collect-or-report)	MA (software nexus) OH (software nexus)	OK (collect-or-report) PA (collect-or-report)	PR (report) RI (collect-or-report)

Economic nexus

As of August 15, 2018

State	Threshold	Effective Date
Alabama	$250,000 and one or more nexus-creating activities	October 1, 2018
Connecticut	Regular or systematic solicitation of sales, plus $250,000 and 200 transactions	December 1, 2018 (previous standard in effect until December 1, 2018)
Hawaii	$100,000 or 200 transactions	July 1, 2018
Illinois	$100,000 or 200 transactions	October 1, 2018
Indiana	$100,000 or 200 transactions	TBD (pending resolution of state litigation regarding economic nexus law)
Iowa	$100,000 or 200 transactions	January 1, 2019
Kentucky	$100,000 or 200 transactions	October 1, 2018
Louisiana	$100,000 or 200 transactions	DoR aiming for January 1, 2019
Maine	$100,000 or 200 transactions	July 1, 2018

Economic nexus, continued

As of August 15, 2018

State	Threshold	Effective Date
Maryland (proposed)	$100,000 or 200 transactions	October 1, 2018 (pending adoption of emergency regulation)
Michigan	$100,000 or 200 transactions	October 1, 2018
Minnesota	Regular or systematic solicitation of sales, plus either 100 transactions or 10 or more transactions totaling over $100,000	October 1, 2018
Mississippi	$250,000 plus purposeful or systematic exploitation of the Mississippi market	September 1, 2018
Nebraska	$100,000 or 200 transactions + meet “doing business” definition	January 1, 2019
Nevada (proposed)	$100,000 or 200 transactions	TBD
New Jersey	$100,000 or 200 transactions	October 1, 2018
North Carolina	$100,000 or 200 transactions	November 1, 2018

Economic nexus, continued

As of August 15, 2018

State	Threshold	Effective Date
North Dakota	$100,000 or 200 transactions	October 1, 2018
South Dakota	$100,000 or 200 transactions	TBD (pending resolution of state Wayfair litigation)
Tennessee	$500,000 and regular or systematic solicitation	TBD (pending resolution of state litigation regarding state economic nexus rule and approval by General Assembly)
Utah	$100,000 or 200 transactions	January 1, 2019
Vermont	Regular, systematic, or seasonal solicitation of sales, plus either $100,000 or 200 transactions	July 1, 2018
Washington	$100,000 or 200 transactions	October 1, 2018
Wisconsin (proposed)	TBD (likely $100,000 or 200 transactions)	October 1, 2018
Wyoming	$100,000 or 200 transactions	TBD (pending resolution of state litigation regarding economic nexus law)

Economic threshold + software-related presence

As of August 15, 2018

State	Threshold	Effective Date
Massachusetts	$500,000 and 100 transactions for retailers with software in state (apps, cookies, etc.)	October 1, 2017
Ohio	$500,000 for retailers with software or content distribution networks in state	January 1, 2018

Income tax consequences

The repeal of the *Quill* physical presence standard has corporate income tax implications, as well

— Although many states assert economic nexus for corporate income tax purposes, not all states have specific or bright-line economic nexus authority

— States may well re-evaluate their economic position in light of the overturn of *Quill*

Steps to consider

— To the extent *Quill* was relied on for a non-filing position, that should likely be re-evaluated and nexus documentation updated

— Reserves may need to be increased in jurisdictions with pre-*Wayfair* economic nexus position if entity is not fully reserved

— Consider the impact of registering for sales/use tax on possibility of nexus questionnaire or other income tax inquiry by state

— Consider possible pursuit of a VDA if non-filing position is questionable

— Monitor state announcements carefully

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Use tax notice and reporting requirements

Reporting requirements

Overview

— A number of states require (by statute) retailers that are not obligated to collect and remit tax to comply with certain notice and reporting requirements

— These requirements generally consist of (1) certain reports to customers and the state taxing authorities and (2) notices to customers at the point-of-sale that use tax may be due

Why would a state adopt a law like this?

— These requirements are meant, in part, to increase purchaser awareness of their use tax obligations

— They are also likely intended by the states to induce remote sellers to voluntarily collect and remit tax as the requirements can be extensive and the penalties for noncompliance can be steep

Where did this come from?

In 2010, Colorado adopted use tax notice and reporting requirements that applied to non-collecting retailers

The three reporting requirements, which finally became effective on July 1, 2017, are as follows:

— Notify purchaser at the time of sale that use tax may be due and purchaser is responsible for filing return

— Notify each Colorado purchaser annually of the volume of goods purchased during the year, that use tax may be due, and that the purchaser must file a use tax return, usually with the income tax

— Notify state tax authority annually of the amount of goods purchased by each Colorado customer along with a general description of the goods purchased

Notice and reporting requirements

State	Transactional Notice(s)	Annual Report to Purchasers	Annual Report to Department
Colorado	Starting July 1, 2017	January 31, 2018	March 1, 2018
Georgia	Starting January 1, 2019	January 31, 2020	January 31, 2020
Louisiana X	Starting July 1, 2017	January 31, 2018	March 1, 2018
Oklahoma	Starting July 1, 2018	January 31, 2019	January 31, 2019
Pennsylvania	Starting April 1, 2018	January 31, 2019	January 31, 2019
Puerto Rico	Starting July 1, 2017	January 31, 2018	Quarterly Report: Oct. 31, 2017
Rhode Island	Starting August 17, 2017	January 31, 2018	February 15, 2018
South Dakota X	Starting July 1, 2011	N/A	N/A
Vermont	Starting July 1, 2017	January 31, 2018	January 31, 2018
Washington	Starting Jan. 1, 2018	February 28, 2019	February 28, 2019
X = no penalties are specified for noncompliance			

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Marketplace provider obligations

Marketplace provider obligations

Certain states have begun to impose tax collection or reporting obligations on online marketplace operators ("marketplace providers" or "marketplace facilitators")

- Requirements generally apply to companies that help, in varying degrees, to facilitate sales by advertising, fulfillment, or payment processing
  - Specific definitions vary by state
- In some states, marketplace operators may elect to collect sales tax or comply with notice and reporting obligations

Penalties for failure to comply with collection and/or reporting obligations can be significant

Marketplace provider obligations

State	Must Collect	Must Collect or Report	Must Report	Effective Date
Alabama		X		January 1, 2019
Connecticut	X			December 1, 2018
Iowa	X			January 1, 2019
Minnesota	X			October 1, 2018
Oklahoma		X		July 1, 2018
Pennsylvania		X		April 1, 2018
Rhode Island			X	August 17, 2017
Washington*	X			October 1, 2018 (Collect or report effective January 1, 2018)

*** Marketplace facilitators with at least $100,000 or 200 transactions in Washington must collect; marketplace facilitators that do not meet those thresholds, but have $10,000 in Washington sales, may have a collect or report obligation.**

Marketplace provider obligations – use tax notice and reporting

State	Transactional Notice(s)	Annual Report to Purchasers	Annual Report to Department
Alabama	Starting January 1, 2019	Unspecified	Unspecified
Oklahoma	Starting July 1, 2018	January 31, 2019	January 31, 2019
Pennsylvania	Starting April 1, 2018	January 31, 2019	January 31, 2019
Rhode Island	N/A	N/A	January 15, 2018
Washington*	Starting January 1, 2018	February 28, 2019	February 28, 2019

*** Marketplace facilitators with at least $100,000 or 200 transactions in Washington must collect; marketplace facilitators that do not meet those thresholds, but have $10,000 in Washington sales, may have a collect or report obligation.**

Next steps

Infrastructure needs change overnight!

Quick change in rules = Quick change in infrastructure needs for sales tax

Nexus in few/no states	Nexus in several states
Minimal sales tax research maintenance	Tax research (rates/rules) required for multiple jurisdictions
Simple/non-existent sales tax compliance and reconciliation process	Need for compliance and reconciliation processes/tools to meet deadlines
Minimal/no audits or potential audits	Prepare for audits

"Zero to Prepared" immediately

Navigating a world without *Quill*

Step 1 – Review Existing and Post-*Quill* Nexus Footprint

- Existing filing obligations – consider VDA/amnesty programs
- Assess post-*Quill* filing obligations

Step 2 – Consider the Overall Business Implications

- Communicate with all stakeholders in the organization
- Involve legal, marketing, supply chain, technology, direct tax, finance

Step 3 – Review Product/Service Mix

- Develop taxability determinations
- Examine bundled items

Step 4 – Review and Consider Technology Needs

- What do you have and what are your options?
- Consider tax engine upgrades or outsourcing compliance processes

Step 5 – Filing Compliance and Initial Registration

- Register in new jurisdictions
- Ensure that all returns and remittances are timely filed

Step 6– Monitor Tax Updates and Handle State Audits

- Stay abreast of tax updates (nexus, rates, exemptions, etc.)
- Prepare for increased audit activity with new jurisdictions

Post-*Quill* readiness checklist

Issue		*Action*
Has your company reviewed its existing and Post-*Quill* nexus footprint?	NO	— Nexus Impact Review — VDA and Business Registration
YES		
Has your company considered the overall business implications of *Quill* being overturned?	NO	— Business Strategy Roadmap — Tax Transformation & Business Change Management — Potential ASC 450 Impact
YES		
Has your company reviewed its product/service mix in each new jurisdiction to determine taxability?	NO	— Taxability Review — Product Mapping
YES		
Has your company evaluated its technology needs now that *Quill* has been overturned?	NO	— Diagnostic Review — Software Selection — Tax Engine Implementation
YES		
Does your company's compliance team have the capacity to register in new jurisdictions, file all necessary returns, and maintain exemption certificates?	NO	— Indirect Tax Compliance Service — Exemption Certificate Support Service — Business License Registration Service
YES		
Is your company able to monitor tax updates and handle increased state audits?	NO	— Updates on tax legislation and changes — Audit support and controversy

Q&A

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