



Sales and Use Tax Update

May 22, 2019

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Note: The contents of this presentation are abbreviated in nature and are not intended to be relied upon as legal advice. Adequate research in regard to any particular fact pattern should be done before making business decisions.

Sales and Use Tax Nexus

- A quick overview of sales and use tax nexus concepts and history.

POLLING QUESTION

- Who is familiar with nexus concepts?
 - What is nexus?
 - Yes, but only in regards to income tax.
 - Yep, could write a book about it!

Sales and Use Tax Nexus

What is this "beast" called
Nexus?

- Nexus is a term used to describe when a State has the Constitutional authority to impose a tax, or a tax collection responsibility on a person.
- The Constitution gives the Federal government limited powers.
- One of those powers is to regulate interstate commerce.

Sales and Use Tax Nexus

A Short History Lesson – Why was Congress given this power?

- The Founding Fathers allowed for Congress to regulate interstate commerce based on observed problems in the colonial period.
- Namely, local governments and States were capriciously charging tolls and taxes.
- The danger of an internal trade war was significant and harmed the flow of goods and services.

Sales and Use Tax Nexus

Congress = the absentee landlord

- Congress has the authority to regulate Nexus but has failed to do so.
- There have been efforts such as *marketplace fairness* and *mainstreet fairness*, but have failed to become law.
- Instead, Nexus has developed through Supreme Court case law.

Sales and Use Tax Nexus

Federal Limitations on State Power – 2 Main Provisions

- **Due Process Clause** (14th Amendment)
 - Requires – Fundamental Fairness in governmental dealings.
 - This means Notice must be given to the person, and
 - They must have an opportunity to be heard.
 - In addition, there must be some obvious connection or economic benefit from the contact with the State. *Not arbitrary, not inconsequential, not*

Sales and Use Tax Nexus

More on Due Process – very important concept for Nexus

- **Fundamental fairness** means a fairly applied rule of law must govern. Not a two-tiered system where “super” citizens benefit.
- **Proxy for notice:** the person must have minimal contacts with the State and therefore some warning that tax may be due.
- A **right to be heard** means: to protest, to present evidence, etc.
- **Cannot be discriminatory** between States. Simply put, a State cannot tax citizens of other states more than their own citizens.

Sales and Use Tax Nexus

Federal Limitations on State Power – the Second Provision

- Commerce Clause

- Again, Congress has authority to regulate interstate commerce.
- Where Congress **hasn't** acted the Supreme Court created a “Dormant” Commerce Clause.
- This dormant commerce clause prevents a State from unduly burdening interstate commerce for self-interested reasons.

Sales and Use Tax Nexus

How does the Commerce Clause function?

- This is a broad authority and can involve direct or indirect activities which impact commerce.
- Kidnapping laws, Gun laws, drug trafficking, racketeering, etc. all based on the commerce clause.
- This is intended to “even the playing field” and prevent economic “balkanization” but not to reduce State taxes.

Sales and Use Tax Nexus

The Supreme Courts "Dormant" 4-Part Test?

The Court established a **4-part test** for the commerce clause (*Complete Auto* case). A state can impose a tax when:

1. It applies to activity with **substantial nexus** to the state (i.e. sales or services performed in the state).
2. **Fairly-apportioned** between states (cannot tax another state's income or activity in another state).

Sales and Use Tax Nexus

The Supreme Courts "Dormant" 4 Part Test, Continued?

The Court's 4-Part Test ... Continued:

3. Does not **discriminate** against interstate commerce.

higher tax - OK cannot impose a higher tax on Texans.

4. **Fairly-related** to services the State provides

roads, property taxes
go for schools, police and
fire, etc.

Sales and Use Tax Nexus

Previous Law before Wayfair...

- Previously, nexus existed when a taxpayer had a **minimal physical contact** (*per Quill and National Bellas Hess*)
- This could be an employee, agent, inventory, location, entry of a company delivery vehicle, or other asset.
- Not mere payments received, not merely passing through a State, but setting foot was the trigger.

Sales and Use Tax Nexus

How did States respond to lost revenue from remote sellers?

- With the growth of remote sellers over the internet not collecting tax, some states tried different strategies:
 - Some tried to pass **hybrid taxes**, which were neither sales tax nor an income tax (Ohio CAT, WA B&O Tax, etc).
 - These taxes did not fall under the physical presence requirement because they were **not sales taxes**.

Sales and Use Tax Nexus

How did states response to lost revenue from remote sellers? Continued...

- Some lobbied for Congressional action.
 - This resulted in proposed legislation such as **Mainstreet and Marketplace Fairness**.
 - These bills would have required some remote sellers to collect sales tax in certain circumstances.

Sales and Use Tax Nexus

How did states response to lost revenue from remote sellers? Continued...

- Some attempted to impose affiliate or attributional nexus.
- **Affiliate** nexus is where a webstore (Amazon) has some agent in the State who facilitates sales.
 - Some states deemed that these Affiliates gave nexus to their principal.
- **Attributional** nexus is where a distinct legal entity with similar or shared branding gives nexus to a related entity.

Sales and Use Tax Nexus

How did states response to lost revenue from remote sellers? Continued...

- Some attempted **multi-state cooperation** such as the SSTA (Streamlined Sales Tax Association) and MTC (Multistate Tax Commission).
 - Streamlined allowed for agreed upon definitions and procedures (i.e. destination sourcing and single state-level tax administration).
 - The MTC allowed for multi-jurisdictional VDAs, certificates, and cooperation between states on audits.

Sales and Use Tax Nexus

How did states response to lost revenue from remote sellers? Continued...

- All of these strategies had some success, but did not require the major remote sellers to collect sales tax universally.
- Therefore some (like SD) attempted to impose **economic nexus** to get around physical contact.
- Eventually one of these cases (Wayfair) made it to the Court and *Quill* and *National Bellas Hess* were overturned.

Sales and Use Tax Nexus

The Wayfarer Case

- In June 2018 the Supreme Court ruled on a sales tax case *SD v. Wayfair, Inc.*
- This *vacated* the previous rulings in *Quill* and *National Bellas Hess* regarding physical presence requirement for nexus.

Sales and Use Tax Nexus

The Wayfarer Case – What did it do?

- It opened the door for economic nexus standards and removed the physical presence test.
- It does not mandate economic nexus but allows for it. Each State has to impose the new nexus.
- They lambasted the prior ruling and augmented State sovereignty.

Sales and Use Tax Nexus

What did SD want to do?

- The SD law imposed nexus “as if the seller has physical presence” when the following conditions applied:
 - \$100,000 or more worth of goods into SD, or
 - 200 or more transactions in the State.

Sales and Use Tax Nexus

Why was the SD law upheld? New Type of Presence, Market Distortions

The Court stated that:

- Due process can be met **without a physical presence** in the modern economy.
- A **website** accessible from residents is **similar to physical presence**.
- That the prior ruling created **market distortions**, acerbated by technological advances.

Sales and Use Tax Nexus

Why was the SD law upheld? Court RIPS the prior ruling..

The Court complained that:

- The physical presence requirement created an **artificial tax** shelter, imposed by the Court.
- The physical presence requirement therefore **hindered economic development** which would have otherwise occurred.
- The Court lamented the **loss of State revenue**.

Sales and Use Tax Nexus

Why was the SD law upheld? The Court's critical "naval gazing" on the prior ruling..

- Prior ruling created **arbitrary application of nexus** instead of "a sensitive, case by case analysis..."
- Stated that the prior ruling was an, "**extraordinary imposition** ... on State's authority to collect tax and perform critical public functions."

Sales and Use Tax Nexus

Why was the SD law upheld? The Court's critical "naval gazing" on the prior ruling..

- The arbitrary ruling made **inequitable competitive** environment between sellers.
- In other words, the prior nexus standard served to **penalize traditional brick and mortar stores** and give an advantage to remote sellers.
- This **advantage was being used** by remote seller's to augment their sales (i.e. no sales tax).

Sales and Use Tax Nexus

Why was the SD law upheld? Stare Decises can be Vacated.

- It rejected “**stare decisis**” due to the **extraordinarily** bad results from the prior ruling.
- It noted that **precedent was not absolute** but can be vacated when there is a clear error.
- Numerous examples of precedent being abandoned after the implications of a ruling are found to be problematic.
(*Plessy v. Ferguson, Dred Scott, Brown v. Board of Education, etc*)

Sales and Use Tax Nexus

Why was the SD law upheld? Reliance not an Issue.

- The Court also stated that **detrimental reliance** was not an issue because:
 - mere tax avoidance does not “found a Constitutional right,” and
 - existing nexus was already difficult. The prior ruling did not help this much. Just created new problems.

Sales and Use Tax Nexus

Why was the SD law upheld? New Tech and Missing State Revenue Concerns

- The prior ruling was **anachronistic** due to technological ecommerce developments.
- A major issue was how much revenue the State was **not able to collect** due to the difficulty of consumer use tax compliance.
- Because **use tax is practically uncollectable from consumers**, sales tax must be relied upon for revenue.

Sales and Use Tax Nexus

Why was the SD law upheld? Disregard of Compliance Cost

- Concerns of increased compliance costs for small taxpayers was disregarded because:
 - Congress could easily fix it, and
 - The judges expect vendors to create software in response to their ruling.
 - The State showed interest in helping with compliance burdens.

Sales and Use Tax Nexus

Why was the SD law upheld? Law had Adequate Protections

- The court indicated that the SD law had adequate Constitutional protections because it:
 - Did not provide for retroactive application. Only to date law was enacted.
 - Allowed for small seller exclusion.
 - Only sellers with substantial privilege of market access have to collect sales tax.

Sales and Use Tax Nexus

Why was the SD law upheld? Law had Adequate Protections, Cont...

- The court indicated that the SD law had adequate Constitutional protections because:
 - SD is a party to the **Streamlined Sales Tax Agreement**.
 - This provides for **similar language and tax treatment**.
 - **Software** to ease the compliance burden.
 - **Single state-level tax**

Sales and Use Tax Nexus

Why was the SD law upheld? Law had Adequate Protections, Cont...

- **Adequate** Constitutional protections, cont...
 - In-state businesses pay these **same** sales taxes. The rates are not discriminatory.
 - If a seller believes a new law is discriminatory for other reasons, **they can still sue.**

Sales and Use Tax Nexus

What is the new rule then for Nexus? A New 4-Prong Test

- The Court will allow a state to impose economic nexus if it meets certain conditions.
- We have identified a new **4-Prong Test**:
 1. Cannot be **discriminatory** (in-state & OOS must pay same tax).
 2. Cannot be **retroactive**. It can be to the date the new law was enacted.

Sales and Use Tax Nexus

What is the new rule then for Nexus? A New 4-Prong Test

- We have identified a new **4-Prong Test**, continued...

3. Must have a **small-seller exclusion** of some type.

- The Court did not assign a threshold on this, only favored the existence of such a provision.

4. State probably needs to be **SSTA** or something similar, which provides for **taxpayer assistance** with the ~~compliance burden.~~

Sales and Use Tax Nexus

What states have imposed an economic nexus standard?

States have “mostly” mirrored the SD law in some fashion. **This is highly fluid.**

Currently:

- AL, AR, AZ (pending), CA, CO, CT, DC, FL (pending), GA, HI, IA, ID, IL, IN, KS (pending), KY, LA, MA, MD, ME, MI, MN, MO (pending), MS, NC, ND, NE, NJ, NM, NV, NY, OH, OK, PA, RI, SC, SD, TN (pending), TX, UT, VA, VT, WA, WI, WV and WY
- Every state had jumped or will jump on the “band wagon” of economic nexus.

Sales and Use Tax Nexus

State Specific Details

In the following slides we have specific information about the various states and where they are with economic nexus.

Please note that this information is changing rapidly so this may be out of date at any time as state's refine their approach.

Most following the general scheme of South Dakota but have some unique features.

What are the States doing with
the recent developments in
Nexus?

States with Nexus Effective Dates Before SD vs Wayfair

Sales and Use Tax

Nexus

States with the Oldest Nexus Laws

- **Tennessee**

- July 1, 2017
- \$500,000+ in gross sales **Tennessee has proposed legislation that would change the threshold to \$100,000 or 200+ transactions.*
- Previous 12 months
- However, legislation enacted in 2017 prohibits the department from enforcing the rule until the General Assembly reviews the Wayfair decision. The department will not apply the economic nexus rule retroactively. This is still pending at this time. TN suggests voluntary collection for now.

- **Massachusetts**

- October 1, 2017
- \$500,000+ in gross sales and
- 100+ transactions
- In the preceding calendar year

States with Nexus Laws Effective Last Year

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Nexus

States with Nexus Laws Effective in 2018 - \$100,000 Threshold

North Dakota

- Effective: October 1, 2018
- \$100,000
- Previous or current calendar year
- Taxable Sales

South Carolina

- Effective: November 1, 2018
- \$100,000
- Previous or current calendar year
- Gross sales

**North Dakota removed the 200+ transaction threshold beginning after December 31, 2018*

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Nexus

States with Nexus Laws Effective in 2018 - \$100,000 or 200 Transactions

- Maine
- Maryland
- Nevada
- New Jersey
- North Carolina
- Utah
- Vermont
- West Virginia
- Wisconsin
- Iowa*
- Hawaii
- Illinois
- Indiana
- Kentucky
- Michigan
- **South Dakota**

*Effective July 1, 2019, Iowa no longer has the 200 transaction threshold.

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Nexus

States with Nexus Laws Effective in 2018 – \$250,000 and Higher Thresholds

- Mississippi \$250,000+ in gross sales in the prior 12-month period
- Alabama \$250,000+ in **retail** sales in the previous calendar year
- Georgia \$250,000+ in both taxable and nontaxable **retail** sales or 200+ transactions in the prior or current calendar year*
- Connecticut \$250,000+ and 200+ transactions
- New York \$300,000+ in gross sales and more than 100 sales in the immediately preceding four sales tax quarters.
- Ohio \$500,000+ in gross sales or provides or enters into an agreement with another person to provide a content distribution network in Ohio to accelerate or enhance the delivery of the seller's web site to consumers, provided the seller has gross receipts in excess of \$500,000

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Nexus

States with Nexus Laws Effective in 2018 – Unusual Thresholds

Minnesota

- October 1, 2018
- \$100,000 and 10 sales *or*
- 100 transactions
- The 12-month period ending on the last day of the most recently completed calendar quarter

Oklahoma

- July 1, 2018
 - \$10,000 *or*
 - Comply with Notice and Reporting Requirements
 - Preceding Calendar year
- *There may be additional economic nexus legislation in the pipeline*

Washington

- January 1, 2018
 - \$10,000 *or*
 - Comply with Notice and Reporting Requirements
 - Current or preceding calendar year
- October 1, 2018
 - \$100,000 in annual gross sales

States with Nexus Laws Effective This Year

Sales and Use Tax

Nexus

States with Nexus Laws Effective This Year (2019) –
\$100,000 Threshold

- Colorado
 - Grace period through May 31, 2019
 - Gross sales
- Idaho
 - Effective: June 1, 2019
 - Gross sales
- New Mexico
 - Effective: July 1, 2019
 - Taxable sales (excluding sales on marketplace if provider collects and remits)
- Pennsylvania
 - Effective: July 1, 2019
 - Gross sales (excluding sales on marketplace if provider collects and remits)

Sales and Use Tax

Nexus
States with Nexus Laws Effective This Year (2019) –
\$100,000 or 200 transactions

- Arkansas
- District of Columbia
- Louisiana
- Nebraska
- Virginia
- Rhode Island
- Wyoming

Sales and Use Tax

Nexus

States with Nexus Laws Effective This Year (2019) –
\$500,000 Threshold

- Texas
- California

States with Pending Nexus Laws

Sales and Use Tax

Nexus

States with Pending Nexus Laws

- Arizona
- Florida
- Missouri
- Kansas

Sales and Use Tax

Nexus

States with Pending Nexus Laws -
Arizona

- AZ Bill #HB2702 (section 42-5043)
- Introduced February 13, 2019
- \$100,000 or 200+ transactions
- Previous or Current Calendar Year
- Effective Date: October 1st, 2019
- Passed the House Ways and Means Committee February 20, 2019

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Nexus

States with Pending Nexus Laws -
Florida

- FL Bill CS/SB 1112: Taxation (lines 870-889)
- Introduced February 15, 2019
- \$100,000 or 200+ transactions
- Previous Calendar Year
- Passed by the Commerce and Tourism Committee March 11, 2019 and the Finance and Tax Committee April 16, 2019
- Indefinitely Postponed and Withdraw from Consideration in Appropriations

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Nexus

States with Pending Nexus Laws -
Missouri

- MO HCS HB 548
- Introduced January 14, 2019
- \$100,000 or 200+ transactions and no physical presence within MO and the associated sales occurred with the use of the Internet
- Previous 12-month period
- Effective Date: January 1, 2020
- Floor action waiting to be sent to the Senate

Sales and Use Tax

Nexus

States with Pending Nexus Laws –
Kansas

- KS H.B. 2033
- Introduced January 16, 2019
- \$100,000
- Previous Calendar Year
- Effective Date: October 1, 2019
- Vetoed by the Governor and returned to the House May 17, 2019

But what about the N.O.M.A.D states? How are they handling the South Dakota v. Wayfair ruling?

Sales and Use Tax

Nexus

Brief Glimpse of the N.O.M.A.D
States

- New Hampshire
- Oregon
- Montana
- Alaska
- Delaware

Sales and Use Tax Nexus

Take Aways

- Know where your company is making sales by both Dollar Amount and Number of Transactions.
- Know which of these States have an economic nexus standard now, or whether it is pending and when?

Sales and Use Tax Nexus

Take Aways, cont...

- For non-economic nexus, you still need to know where your physical connections are?
- Employees, agents, assets and how goods are delivered, etc?
- If in doubt, register and get a permit. At least you have statute of limitations protection.

Sales and Use Tax Nexus

Trends!

- States will begin auditing this issue over the next few years.
- More legal challenges could result and that could spur Congressional action.
- Non-permitted taxpayers will have increasing risk and may have to prove they did NOT sell into a state.

Sales and Use Tax Nexus

How do I reduce my Risk?

- Permit early and permit often.
- Choose the least frequent filing status you can to reduce costs.
- Certificates and solid compliance needed.
- Prepare for audits and investigations. Keep excellent records.

Sales and Use Tax Nexus

How do I reduce my Risk?

- You need to understand the following for each of your new States:
 - Taxability of your products and services.
 - Tax base,
 - Sourcing of local tax and applicable rates,
 - Certificate standards and which

Q and A

Who is MERIT Advisors?

- MERIT is a full-service provider of:
 - Appraisal and property tax solutions for Oil & Gas Companies, Construction, Manufacturers and Service Firms, Business Personal Property, and Commercial Property
 - Sales Tax Consulting Services - audit defense, refunds, advice, software implementation, nexus determination and subsequent exposure minimization and remediation.
 - Business Incentive Programs - tax exemptions, credits and rebates, local infrastructure assistance, etc.
- Merit has about **50** employees - Most managers and directors have over **20** years experience. They are a leading provider of property tax services to the oil and gas industry, and has extensive

Merit Advisors—Mike Miller

Biography

- Mike Miller CPA, is a Principal and works in sales, use and severance tax consulting in Merit's Tulsa office. Prior to joining Merit, Mr. Miller served as Tax Manager at KPMG and HoganTaylor, and as a sales and use tax auditor for the State of Texas. Mike is an Oklahoma CPA, and a member of the AICPA, the Institute for Professionals in Taxation, and the OSCP.
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THANKS !!

- Please call if you have questions or would like to discuss an issue further.
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