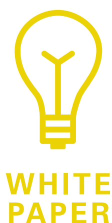

Tax Guidance for Interstate Sellers Post *South Dakota v. Wayfair*

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For years the physical presence standard enacted by the 1992 Supreme Court Case *Quill v. North Dakota* was the primary determinate as to whether states were justified in requiring out of state businesses to collect and remit sales tax.

That all changed on June 21st, 2018 when the U.S. Supreme Court overturned the Quill decision by siding with the states in *South Dakota v. Wayfair, Inc.* The Court concluded that states like South Dakota were unjustly missing out on billions of dollars in revenue by not imposing sales tax collection and remittance upon online retailers who lack a physical presence in their states.

South Dakota now follows an economic presence standard in creating sales tax nexus, in which remote sellers making sales into the state exceeding $100,000, or having 200 or more transactions into the state, in the current or previous year have a requirement to register, collect, and remit South Dakota sales tax, regardless of whether they have a physical presence in South Dakota.

Background on *South Dakota v. Wayfair, Inc.*

In 1992, North Dakota attempted to levy sales tax on Quill Corporation for doing business in the state. Quill, however, successfully argued that because they were merely doing business through out-of-state mail orders and phone calls, they did not have an obligation to register, collect, and remit sales tax in a state in which they had no physical presence. Thus, the physical presence standard was created, and since that decision, countless remote sellers have depended upon this standard for doing business and tax planning strategies.

The case was revitalized in early 2016 when Supreme Court Justice Anthony Kennedy noted that the Quill decision had become dated. In the early nineties, it was impossible to anticipate the prevalence of the internet and e-commerce, which composed a fraction of interstate sales at that time in contrast to the $450 billion industry it is today.

Several states decided to challenge the Quill decision in light of Justice Kennedy's willingness to revisit the case. South Dakota, who does not impose an income tax and relies heavily on sales tax revenue, passed remote seller legislation, imposing sales tax collection responsibilities on out-of-state retailers selling into the state. Following the legislation, the state sued *Wayfair, Inc.* among other online retailers, for compliance. The case would eventually reach the Supreme Court, and in a 5-4 ruling, the U.S. Supreme Court overturned Quill's physical presence standard.

South Dakota v. Wayfair Implications: State Reaction

Many states were expected to change their nexus laws / regulations following the Supreme Court's decision in *Wayfair*, and most have now enacted economic presence standards that are currently in effect or will become effective in 2019.

States including Alabama, Georgia, Hawaii, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Massachusetts, Mississippi, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Vermont, Washington and Wyoming, have proposed or enacted economic sales tax nexus thresholds prior to the *Wayfair* decision. Going forward, these states are now expected to take action to enforce these requirements.

The question remains as to whether the economic nexus thresholds established by these states are discriminatory against interstate commerce. For example, a company that sells low dollar value items may easily surpass a 200 transaction per year threshold but yet be nowhere near the gross sales threshold. This could significantly impact such a company's ability to continue to sell into the state because of the additional administrative costs it would take to comply with sales tax filing requirements.

Most states have enacted standards similar to South Dakota since it was reviewed by the U.S. Supreme Court as not discriminating against interstate commerce. However, there are many differences in other states that may lead to a constitutional challenge. For the time being and with no further action by Congress, states are free to set their standards for remote sellers that may ultimately be determined to fail the commerce clause of the U.S. Constitution through their reliance on *Wayfair*.

CHAPTER 1

After the *Wayfair* Sales Tax Case: Getting a Handle on Your Sales Tax Obligations

9 STEPS TO FIGURING OUT WHAT YOU MUST COLLECT AND WHO YOU HAVE TO PAY.

The U.S. Supreme Court's decision in *South Dakota v. Wayfair, Inc. (Wayfair)* expanded the ability of states to require remote sellers to collect and remit sales taxes on transactions in jurisdictions where the seller has no physical presence. In short, the court held that a state law requiring remote sellers to collect and remit a state's sales tax based on an "economic nexus" threshold did not automatically violate the U.S. Constitution's Commerce Clause.

The opinion remanded the case for further action without specifically ruling on the constitutionality of the South Dakota law. However, the justices highlighted several features of the law that they felt would keep it from imposing an undue burden on interstate commerce, including:

- A safe harbor threshold that limited the application of the law to remote sellers with more than just "limited business" in the state. In South Dakota's case, the law does not require the remote seller to collect and remit sales tax if it has less than $100,000 or 200 transactions in the state during the previous or current calendar year;
- A prohibition against retroactive enforcement;
- One state-level administration of all sales taxes within the state; and
- Access to sales tax administration software provided by the state.

Many states already had economic nexus laws before the *Wayfair* decision, and a host of others have enacted similar laws since the Supreme Court's ruling. The terms of these laws can vary significantly from South Dakota's. Because the factors listed by the court are only guidelines on what the justices thought would pass Constitutional muster, there is still considerable uncertainty over what requirements might be found unconstitutional if or when challenged.

A Nine Step Action Plan for Remote Sellers

With so many details still up in the air on this topic, many businesses are struggling to figure out how to comply with current requirements and adapt quickly to new rules as they are enacted. The following nine steps can help any business that sells products or services into multiple states meet current state tax obligations and manage changes effectively.

1 **Determine where, what, and to whom you sell.**

- The reason for the "where" determination is fairly obvious, but keep in mind you should be tracking not just the destination state, but also local jurisdictions that may have additional sales tax requirements.
- Our system needs to know "what" you are selling in each jurisdiction because sales tax rates can vary from product-to-product or service-to-service, or may be exempt from sales tax.
- You need to track your customer information in order to know if a buyer qualifies for a sales tax exemption.

2 **Determine your activities that could create physical and economic nexus.** Remember, the *Wayfair* decision didn't eliminate physical presence nexus, it simply added economic nexus. Your system needs to allow for the possibility that either standard could trigger a sales tax registration, collection and remittance requirement in multiple states or local jurisdictions within those states.

3 **Review the most recent 12-month period and prior year sales to each state.** The first item in this list is designed to give you a current snapshot of your activities that may trigger economic nexus. A look back at recent periods is also necessary to make sure that you haven't missed an obligation to register, collect and remit sales tax based on previous sales.

4 **Determine the taxability of your products and services in each state.** Once you know where, what and to whom you sell, you need to determine how each local taxing jurisdiction within a particular state taxes your product. Many states have local taxing jurisdictions in addition to a state level sales tax. In fact, Alaska has local taxing jurisdictions but no state sales tax.

5 **Monitor economic nexus.** You need some type of system in place to track both the dollar volume of sales and number of transactions in each state where you sell. Even though sales tax registration, collection, and remittance obligations may not be required until you cross a state's economic nexus thresholds, you need to monitor this early on to know at what point in the future these thresholds will be crossed to plan accordingly.

6 **Monitor changes in state sales and use tax laws.** Many states have adopted economic nexus laws that are the same as South Dakota. You should work closely with your tax advisor and your sales tax compliance software provider to make sure you are aware of any changes in requirements that could affect your company.

7 **Identify each state where you have economic nexus and your goods or services are subject to state and local sales tax.** Penalties for failure to comply with state and local sales tax laws can be significant since they are imposed on a per transaction basis. You need to know what rules apply before you market your goods and services, contract with customers for the sale of such goods and services, bill customers, and collect. If you fail to collect sales tax or an exemption certificate from your customer, then your company may be charged for the amount. In addition, failing to register as a sales tax vendor can result in a penalty in some states.

8 **Review your marketing, selling, billing, and tax collection and payment practices.** You need to look at the whole process from soup to nuts in order to confirm that you're giving your buyers the correct information about what taxes apply and that you're collecting and remitting to the proper authorities.

9 **Evaluate your sales tax exemption certification process.** Your business may not have paid close attention to exemption certificates in the past when you had no physical nexus in a taxing state or local jurisdiction. With more states looking to collect sales tax based on economic nexus, you will need to be more vigilant in monitoring customers that claim an exemption from state or local sales tax. That includes tracking when exemption certificates expire.

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CHAPTER 2

Remote Seller Sales Tax: 8 Critical Questions to Ask About 2019 Sales Tax Obligations

AFTER *WAYFAIR*, THE RULES FOR COLLECTING OTHER STATES SALES TAX HAVE CHANGED

In a short period of time, there have been numerous state reactions to the U.S. Supreme Court decision to overturn the physical presence standard set by *Quill v. North Dakota (1992)* that will undoubtedly affect the sales tax liability of remote sellers in an adverse way. Many state provisions became effective in the last few months of 2018, many more became effective in early 2019, meaning that remote sellers are running out of time to begin compliance. Depending on the jurisdiction, substantial noncompliance penalties can be imposed, and if you have not made it a priority to address these issues, revenue-hungry states will be sure to pursue these tax dollars. Every remote seller should consider the following questions with respect to the new era of sales tax nexus and how they might impact your business.

Remote Seller Sales Tax Question #1

Are we currently collecting and remitting sales tax in all applicable states and local jurisdictions?

The new economic nexus standards are generally not retroactive – but that is not to say that a business is exempt from their sales tax remittance obligation in states where a filing was previously required. If you have physical presence in a state in which you have not filed in the past, it is advisable to begin doing so. Many states offer voluntary disclosure programs that can be advantageous in avoiding costly penalties for prior noncompliance.

Remote Seller Sales Tax Question #2

Are we currently collecting exemption certificates from customers?

While not every business is required to pay sales tax, they are required to support an exempt status. If you don't collect sales tax from a buyer, without a proper exemption certificate, odds are you will be held liable. Generally, you don't need an exemption certificate every time you transact with the same buyer, and many states accept a blanket exemption certificate.

It's important to communicate with your customers that tax will be collected when an exemption certificate is not provided to protect your company in the event of a sales tax audit.

Remote Seller Sales Tax Question #3

Do we know how each state treats our products or services?

Keep in mind that most states have varying definitions of taxable sales. A business product or service can be exempt from sales tax in one jurisdiction and taxable in another. For example, in some states clothing is a taxable item, in others only clothing items over a certain dollar amount are subject to sales tax, and some exempt clothing altogether from sales tax.

Further complicating this matter is that states may define clothing differently. Thorough analysis should be done for every state that you are doing business in.

Remote Seller Sales Tax Question #4

Are we required to register and file in new states and if so, will that create an income tax filing requirement?

In order to collect and remit sales tax in a state, a business needs to be registered with the state's Department of Revenue. Remote businesses should consider that as they register in new states, this action will likely draw attention from the state revenue departments with respect to income and franchise taxes. A determination will need to be made if being registered for sales tax purposes constitutes "doing business" in each state and what additional state income or franchise tax filings may be required.

Remote Seller Sales Tax Question #5

Are changes needed in the people / processes / systems /software to comply?

Even if you have established where you should file, are you equipped with the resources to do so? It can be time-consuming and burdensome, especially for businesses with a large economic footprint to comply with numerous filings considering most states impose a quarterly or monthly reporting. Sales tax software is useful, however you will want to ensure that you select the right package that fits your business needs to avoid incurring unnecessary charges. Additionally, you'll need properly trained personnel to implement and use the software.

Remote Seller Sales Tax Question #6

Are changes needed to our billing procedures?

Consider new states you will be filing in. Are you making both taxable and non-taxable sales to the same customer? Itemizing invoices is vital so that you are only collecting sales tax on taxable items and services. Keep this is mind as you are shopping for software – some might be able to streamline this process.

Remote Seller Sales Tax Question #7

Are changes needed in our marketing materials or customer contracts?

Your customers may be surprised to see an increase on their bills due to sales tax if it was not previously collected. It is imperative that these changes are clearly communicated with new and existing customers. With larger vendor contracts, the dollar impact on the customer can be substantial, and contracts should be amended to reflect that sales tax will be collected if necessary.

Remote Seller Sales Tax Question #8

Are we tracking changes in state sales tax laws as they occur?

Keeping up with various state tax law changes in every state is an onerous task. Sales tax rates can change from year-to-year, sales tax holidays are introduced periodically, and even the taxability of an item can change. If your business is active in many states, it may be necessary to outsource this task or employee someone that is dedicated to sales tax compliance year-round.

CHAPTER 3

Sales Tax Compliance – What, Me Worry?

UNCERTAINTY STILL EXISTS ABOUT WHAT BUSINESSES SHOULD EXPECT AFTER THE *WAYFAIR* DECISION

The recent *Wayfair* decision has sent states and businesses alike scrambling to make sense of what taxes are owed in which jurisdictions. Many business owners and officers may be tempted to backburner the issue. After all, you have enough other fires to put out. You'll get to sales tax compliance when you get to it.

Not so fast. Remember that sales tax, much like employment tax, is considered a "trust fund" transaction. Sales tax isn't additional revenue that is billed to your customer. Rather, it's money that you are deemed to hold as a trustee of the state. You are responsible for collecting and remitting the appropriate sales tax. If you fail to do either, it's not just the company's assets on the line. "Responsible Persons" can be held personally liable for any unpaid sales tax liability.

Who is Responsible for Charging and Collecting Sales Tax?

Most businesses don't run into problems by failing to remit the sales tax they collected. The greatest risk arises from failing to charge and collect sales tax on taxable transactions. In the event of a sales tax audit, the company could be assessed the amount of sales tax that it should have collected and remitted, plus penalties and interest. But because of the trustee relationship, that liability could extend to responsible persons. Who are they?

In New York, owners, corporate officers, LLC members, general partners, and any limited partners who actively run the business or who have at least 20% ownership are automatically responsible persons. In addition, the list of responsible persons generally includes anyone who:

- Is actively involved in operating the business on a daily basis,
- Decides which bills are paid,
- Has hiring and firing authority, or
- Has check signing authority.

If the business has the money to settle the sales tax liability, the responsible persons can breathe a sigh of relief. If the business is unable or unwilling to pay, the responsible persons can be held liable. Generally, your directors and officer's policy will not protect you against this type of omission, so don't think of that as your fail safe.

Long Term Effects and Impacts of *Wayfair*

There is still a lot of uncertainty about the long-term effects of *Wayfair*. Will there be a uniform minimum threshold on either dollar volume or transaction volume? Will there be small business exceptions?

As we wait to see how questions like these are resolved, we recommend starting at the basics: what states are you currently registered in? Are you selling into any states where you are not registered? What products or services are you selling? Do you have employees or contractors in states other than your home state? Taking stock of your current selling practices is the best first step.

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CHAPTER 4

The *Wayfair* Decision and its Impact on Canadian Companies

Before June 2018, Canadian companies could avoid having to comply with U.S. sales tax laws by not establishing a physical presence in any state or municipality within the U.S. However, that changed on June 21, 2018 when the U.S. Supreme Court in *South Dakota v. Wayfair, Inc.,* eliminated the "physical presence" barrier that prevented states from enforcing their sales tax laws on remote sellers. As a result, states can now require remote sellers to comply with their state and local sales tax laws based on economic presence. Therefore, Canadian companies are no longer shielded from complying with sales tax laws by avoiding establishing a physical presence within any state or local jurisdiction within a state. Instead, Canadian companies now need to determine if they have established an economic presence in any state or local jurisdiction and if so, may need to comply with the sales tax laws in those states.

Physical Presence

A series of U.S. Supreme Court cases (most notably *Quill Corp. v. North Dakota*) established that a remote seller must establish a physical presence within a state before the state and local governments can impose its sales tax laws on the remote seller. Physical presence is generally established by having in-state employees or agents, or owning or leasing property within the state. All states with sales tax laws continue to require compliance with their sales tax laws when physical presence exists.

Economic Presence

South Dakota (SD) passed legislation in April of 2016 requiring remote sellers to collect SD sales tax when annual gross revenue from SD customers exceeded $100,000 or when remote sellers completed more than 200 transactions with SD customers. *Wayfair* challenged the law and since the law's requirements weren't based on physical presence, SD lost at each level of appeals. Ultimately, the U.S. Supreme Court determined that physical presence was no longer a requirement to establish nexus (i.e., minimum connection with a state) for sales tax purposes. Instead, nexus can be established based on gross sales to in-state customers or the number of transaction with in-state customers. In addition, the U.S. Supreme Court determined that SD's sales tax laws did not impose undue burden on interstate commerce.

States Reaction to *Wayfair*

Many states have adopted, or are in the process of adopting sales tax laws that are similar to SD thinking that the U.S. Supreme Court approved SD's sales tax laws. However, there are other features to SD's sales tax laws that are unique and may not be present in the laws of other states. Therefore, it is uncertain whether the sales tax laws being adopted by other states in reaction to *Wayfair* will place an undue burden on interstate commerce or whether such laws will create substantial nexus allowing the state to impose its sales tax laws on remote sellers.

States are not bound by tax treaties and such treaties do not apply to non-income based taxes such as sales tax, gross receipts tax, and net worth or capital based taxes. Therefore, the U.S. Supreme Court decision in *Wayfair* extends beyond sales tax, potentially exposing Canadian companies to other state taxes as well.

Congress may finally need to act to alleviate the burden being placed on remote sellers who must now comply with numerous state and local taxing jurisdictions and state-by-state determination of how goods and services are taxed.

Sales Tax Analysis

Canadian companies should maintain a sales tax matrix of every product or service they sell, where the product or service is received by the customer, and whether the product or service is subject to state or local sales tax. The matrix should include both the gross sales and number of transactions in each state and local taxing jurisdiction to determine whether economic nexus is present or could occur in the future. This analysis will help to plan on a state-by-state basis to minimize the burden of sales tax compliance. Sales tax compliance software may be needed to alleviate this burden.

Since all states with sales tax laws continue to require compliance with their sales tax laws when physical presence exists, Canadian companies should determine whether they currently have established physical presence in any state and if so, the amount of their sales tax liability for prior years. State voluntary disclosure programs may prove beneficial and should be considered when sales tax liability exists for prior years.

If sales are exempt, then it may be necessary to begin collecting exemption forms from customers. For example, sales to tax exempt organizations, governmental entities, and sales for resale are generally treated as exempt sales. In advance of collecting exemption forms, states may require registration with the taxing jurisdiction.

CHAPTER 5

What Remote Sellers Need to Know About Use Tax Notice and Reporting Requirements

Since the U.S. Supreme Court ruling on June 21, 2018 that overturned the physical presence standard, most states have rushed to impose an economic nexus standard for remote sellers who meet a dollar or transaction threshold for sales made in the state. This means a seller who has not had a physical presence in a state may need to register, collect and remit state sales tax if it meets the threshold in that state.

However, about a quarter of the states have established use tax notice and reporting requirements that remote sellers may be subject to even if they are not required to collect and remit sales tax in those states. Colorado was the first state to enforce use tax notice and reporting requirements for non-collecting sellers on July 1, 2017, in an effort to work around physical presence nexus standards and ensure buyers pay use tax when sellers are not required to collect and remit sales tax in their state. Now that states are adopting economic nexus standards, more states are likely to impose use tax reporting requirements on sellers who are not required to collect and remit sales tax in their state.

What is "Notice and Report" for Use Tax and Who Does it Affect?

In general, a State notice and reporting law requires remote retailers that are not required to register, collect and remit sales tax to complete an onerous reporting requirement, intended to cause sellers to voluntarily register, collect and remit sales tax.
The report requires the retailer to:

- Put a notice on the retailer's website that use tax may be due on purchases,
- With each sale made, to give the buyer a notice that use tax on their purchase might be due,
- Deliver annual notices to customers exceeding the state's threshold that reminds them that they may owe use tax, and
- Deliver an annual notice to the state with information about their customers' purchases including name, address, date and amount of purchase.

States that Have Use Tax Notice and Reporting Requirements

States that have use tax notice and reporting requirements include Alabama, Colorado, Connecticut, Georgia, Iowa, Louisiana, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Vermont, and Washington.

States with Alternative Use Tax Notice and Reporting Requirements under Economic Nexus Provisions

Pennsylvania, Rhode Island, and Washington, for example, have adopted detailed use tax notice and reporting requirements with the alternative option of electing to register and collect sales tax under economic nexus provisions. In other words, remote sellers who meet the states thresholds must elect to either register, collect, and remit sales tax, or comply with use tax notice and reporting requirements.

There are also penalties for failure to comply with the requirements in some states. In Pennsylvania, for example, each failure to comply may result in a penalty of $20,000 per violation, per year, or 20 percent of total Pennsylvania sales during the previous 12 months, whichever is less.

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CHAPTER 6

Wayfair Sales Tax Case: New York State Responds

VENDORS WITH NO PHYSICAL PRESENCE IN THE STATE MAY BE REQUIRED TO COLLECT AND REMIT NEW YORK STATE AND LOCAL SALES TAX… ARE YOU?

After almost seven months of silence following the Supreme Court's decision in *South Dakota v. Wayfair, Inc.,* taxpayers were finally given an answer to the question of how New York State would respond. On January 15, 2019, the New York State Department of Taxation and Finance announced that effective immediately, vendors with no physical presence in the state are required to register, collect and remit New York State and local sales tax if the specified economic nexus thresholds are met.

How Does New York State Define a Vendor?

For New York State sales tax purposes, a vendor is defined as a person who regularly or systematically solicits business in the state, and as a result, makes taxable sales of tangible personal property or services into New York. One is deemed to be regularly or systematically soliciting business in New York if, for the four most recent sales tax quarters, gross receipts from the sale of property delivered into the state exceed $300,000 and more than 100 sales of tangible personal property were made into the state.

Therefore, a business with no physical presence in New York is now required to register with the state for sales tax purposes if they are making taxable sales into the state and meet both the sales and transaction thresholds.

New York State's Economic Nexus Thresholds

Each state has its own rules on what sales are included, as well as what look-back period should be used when tracking your in-state sales and transactions for their economic nexus thresholds. For New York, all sales of tangible personal property delivered in the state, including both taxable and non-taxable sales, are counted towards the $300,000 and 100 transaction thresholds. For the look-back period, New York will be using the preceding four sales tax quarters. The New York sales tax quarters are March 1st through May 31st, June 1st through August 31st, September 1st through November 30th, and December 1st through February 28th or 29th. This means that for the purpose of tracking sales and transactions to see if the economic nexus thresholds are met, businesses will need to reevaluate their sales tax nexus in New York State on a quarterly basis. Once the thresholds are met, the business is required to register with the state as a vendor and begin collecting and remitting sales tax.

An important distinction regarding New York's economic nexus thresholds is the fact that both thresholds must be met in order for a remote seller to be deemed to have sales tax nexus in the state. This differs from all but one other state, who generally consider an out of state seller to have sales tax nexus if just one of their economic nexus thresholds are met. There is also the issue of what is or is not taxable when looking at local sales tax in New York State.

For example, New York State offers an exemption from sales tax on the sale of clothing or footwear sold for less than $110 per item. This exemption, however, is optional at the locality level, with only ten localities following the state and exempting these items. The remaining localities require the collection of sales tax on these items, each at its own specified tax rate.

If a business only sells clothing that falls under this exemption, they could potentially have no taxable sales into New York State, and therefore, not be required to collect and remit New York State sales tax.

But what if those sales are into localities that do not provide the exemption? Does the business still have an obligation to collect and remit to those localities? Are they exempt from collecting and remitting sales tax to the localities if they do not have a New York State collection and remittance requirement? New York is yet to address complexities such as this, leaving some businesses unsure of their sales tax obligations in the state for the time being.

CHAPTER 7

Software as a Service Sales Tax: *Wayfair's* Impact on SaaS and Digital Goods

If you are a CFO at a business that provides SaaS to clients in multiple states, new state sales tax rules will have an impact on your tax reporting and compliance obligations

The *Wayfair* case and related law changes resulted in significant new state sales tax obligations on many SaaS (software as a service) providers. It's important to understand that these changes could result in new tax collection responsibilities on a SaaS business even in states where you have operated without them in the past.

Executives need to act quickly to make sure that their existing operations are in compliance with the new rules and that their systems can adapt as sales growth and law changes trigger additional obligations.

Two Sales Tax Changes That SaaS Providers Need to Consider

Historically, most states have not imposed their sales tax on payments for services. As a result, SaaS providers were not required to collect and remit sales taxes on transactions in those states. In the 16 states that did impose sales tax requirements on cloud-based services, many SaaS providers were still exempt from the obligations because they did not have a physical connection to the jurisdiction, like an office or a server farm. "Physical presence" was the standard used by the Supreme Court to determine if a business established "nexus" in a state. (Nexus is the level of presence that allows a state to tax an out-of-state entity without violating the Constitution's Commerce Clause.)

These circumstances started to change on June 21, 2018 when the Supreme Court ruled in ***South Dakota v. Wayfair, Inc. (Wayfair)*** that economic activity within a state could also establish nexus.

The ruling determined that a sales tax obligation could be established in some circumstances solely through virtual contacts with a state. Most states have since established some variation of an economic nexus standard. The most common variation requires a company to collect and remit sales tax if it has more than $100,000 in sales to the state, or 200 or more transactions delivered into the state during the preceding or current calendar year.

SAAS SALES TAX BY STATE:

States Requiring Providers to Collect Sales Tax

(as of 2/1/19)

Arizona
District of Columbia
Hawaii
Massachusetts
Mississippi
New Mexico
New York
Pennsylvania
South Carolina
South Dakota
Tennessee
Texas
Utah
Washington
West Virginia

What *Wayfair* Means for SaaS Providers Now

These changes mean that SaaS providers may now be required to collect and remit sales taxes in states where they have operated for years without any obligation.

If your SaaS business crosses the economic nexus threshold in a state that imposes sales tax on services, you will need to bill your clients for those amounts and remit them to the state. In fact, you'll need to start tracking your transactions in the state from the outset in order to know when you cross a threshold that triggers a sales tax obligation. Subscriptions models increase the likelihood that you could become liable, as a monthly billing cycle would generate twelve transactions per year for each client.

What SaaS Providers Can Expect In the Near Future

We noted above that several states already tax the sale of digital products delivered electronically to their residents. As states evaluate their sales tax laws considering this latest change, it seems likely that many more states will introduce legislation extending their laws into the digital goods sector.

For example, sales of digital products were exempt from sales tax in Iowa until January 1, 2019. Now Iowa taxes electronically transferred digital products such as digital books and audio-visual works. Also, the District of Columbia has recently passed emergency legislation to amend the sales and use tax treatment of digital goods sold or used in the District. Effective January 1, 2019, the definition of "retail sale" in the D.C. Code has been expanded to include charges for or the sale of digital goods, such as digital audio-visual works, digital audio works, digital books, digital codes, digital applications and games, and other taxable tangible personal property delivered electronically.

In addition to digital goods, more states are likely to start taxing SaaS and similar cloud-computing services. For example, effective October 1, 2018, Rhode Island made the sale, storage, and use of vendor-hosted prewritten computer software subject to sales tax, and as of January 1, 2019, SaaS is subject to sales tax in Iowa, but an exemption applies for the sales price of SaaS provided to a business for its exclusive use.

Assistance with the Daunting Task of Multi-State Sales Tax Compliance

Following New York's announcement, there are now only two states that have not enacted economic nexus thresholds in light of the *Wayfair* decision. Under these economic nexus rules, remote sellers of tangible personal property and taxable services now have the potential to be subject to sales tax registration, collection, and remittance requirements in dozens of states that they were previously exempt from due to a lack of physical presence.

Understanding the rules and requirements of each state without professional guidance can be a daunting task for a business, however, the importance of compliance cannot be overlooked as there can be harsh penalties for noncompliance.

Connect with the Freed Maxick SALT team at 716.847.2651 to discuss how we can help guide your business through all these sales tax changes following the *Wayfair* sales tax case decision. Or, click below:

Get a fresh look at your tax position and ways to reduce taxable income
Schedule a Tax Situation Review

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