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# Nexus for E-Commerce Businesses



## Nexus

- Defines a level of connection between a taxing jurisdiction and an entity
- Controlled by U.S. Constitution under the Due Process Clause and the Commerce Clause
- Supreme Court has shaped the definition of Nexus
  - *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967)
  - *Quill Corporation v. North Dakota*, 112 S.Ct. 1904 (1992)
  - *Overstock.com, LLC v. New York State Department of Taxation and Finance*, U.S. Supreme Court, Dkt. 13-252; *Amazon.com LLC v. New York State Department of Taxation and Finance*, U.S. Supreme Court, Dkt. 13-259



## Nexus (cont.)

- Maintaining, occupying or using permanently or temporarily, directly or indirectly or through a subsidiary, an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business
- Having a representative, agent, salesman, canvasser, or solicitor operating in this state under the authority of the retailer or its subsidiary on a temporary or permanent basis

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## Nexus (cont.)

- Corporate structure and state of incorporation can impact nexus determination
- Establishment of a LLC in a state separate from the state of operation could create nexus in the LLC incorporation state
- Nexus is generally established in the state where owner/operator/employees reside regardless of state of incorporation/establishment

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# Agency Relationships



## Traditional Agency Nexus

- *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960)
  - Scripto was a Georgia company which made sales into Florida. Scripto did not maintain any offices or facilities in Florida. Nor did it have any employees located in Florida or visiting Florida to solicit sales. Its only activity in Florida was sales solicitation by independent contractors. The court found that this activity by independent contractors provided enough presence for the out-of-state business that it was required to collect tax on sales into Florida.



## Click-Through Nexus

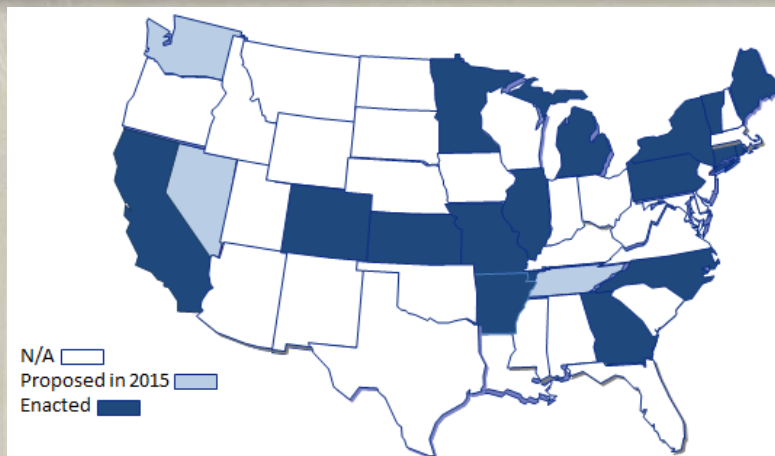
- Typical Attributes of Click-Through Nexus Bills
  - Minimum sales threshold into state
  - Commission payment to in-state resident
  - Commission payments for click-through orders
  - If retailer or service provider contracts with an individual located in-state who refers potential customers to the retailer through a web link for a commission/other consideration upon sale, retailer is considered to maintain a place of business in state

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## Click-Through Nexus: Enacted and Proposed Legislation



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## Update on IL Click-Through Nexus Legislation

- On October 18, 2013, the Illinois Supreme Court ruled that the state's click-through nexus law is pre-empted by federal law. This decision upholds lower court rulings. The Court specifically found that the click-through nexus law is pre-empted by the Internet Tax Freedom Act. The Court found that the relevant provisions of the click-through nexus law impose a discriminatory tax on electronic commerce within the meaning of the ITFA. (*Performance Marketing Ass'n, Inc. v. Hamer*, Illinois Supreme Court, No. 114496, October 18, 2013)

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## Update on IL Click-Through Nexus Legislation (cont.)

- In response to the Illinois Supreme Court decision in the *Performance Marketing Association, Inc. v. Hamer* case, Illinois has enacted revised click-through nexus legislation, effective January 1, 2015. The affiliate nexus provisions which were passed in 2011 have continued to apply and have not been amended. (P.A. 98-1089 (S.B. 352), Laws 2014, effective January 1, 2015)

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## Affiliate Nexus

- Typical Attributes of Affiliate Nexus Bills
  - If an affiliated person of the retailer with a physical presence, or employees or agents in state, has sufficient nexus in state to require the retailer to collect and remit sales and use taxes on taxable retail sales of tangible personal property or services.
  - "Affiliated person" is defined as any person that is a member of the same "controlled group of corporations" as the retailer, or any other entity that, regardless of how it is organized, bears the same ownership relationship to the retailer as a corporation that is a member of the same controlled group of corporations

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## Affiliate Nexus (cont.)

- Typical Attributes of Affiliate Nexus Bills (cont.)
  - If retailer or service provider contracts with an individual located in-state under which the retailer or service provider sells the same or substantially similar products/services using an identical or substantially similar name, trade name, or trademark, the retailer will be considered to maintain a place of business in-state
  - Does not always require common ownership

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## Affiliate Nexus (cont.)

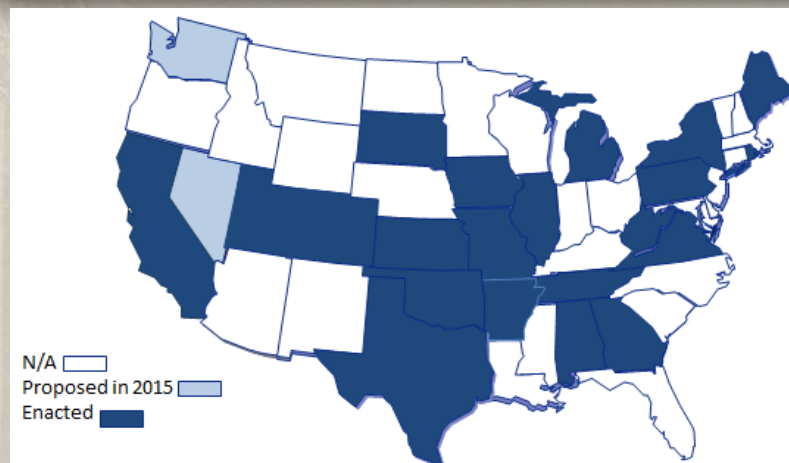
- Typical Attributes of Affiliate Nexus Bills (cont.)
  - Uses trademarks, service marks, or trade names that are the same or substantially similar to those used by the retailer;
  - Delivers, installs, assembles, or performs maintenance services for the retailer's customers within the state;
  - Facilitates the retailer's delivery of property to customers by allowing the retailer's customers to pick up property sold by the retailer at an office, distribution facility, warehouse, storage place, or similar place of business maintained by the person in the state; or
  - Conducts any other activities in the state that are significantly associated with the retailer's ability to establish and maintain a market in the state for the retailer's sales.

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## Affiliate Nexus: Enacted and Proposed Legislation



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## Reporting Legislation

- Typical Attributes of Reporting Bills
  - Applies to retailers that are not registered and collecting sales tax
  - Retailer must notify buyers that they must pay and report state use tax on their purchases
  - Retailers may not advertise that no sales tax is due
  - Retailer may be required to send purchasers an annual statement of all of their purchases from the retailer
  - Retailer may be required to send an annual report to the state department of revenue of the total dollar amount of each in-state customer's purchases on which tax was not collected
  - Threshold may apply

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## Reporting Legislation (cont.)

- 2010
  - Colorado - H.B. 1193, effective March 1, 2010
    - » US District Court issued injunction 3/30/12
    - » US District Ct of Appeals reversed & remanded 8/20/13
    - » Federal district court issued order dissolving the permanent injunction 12/13/13
    - » Denver district court granted motion for a preliminary injunction 2/18/14
    - » U.S. Supreme Court held that a federal district court has jurisdiction over the lawsuit 3/3/15
    - » Remanded to lower court to evaluate actual statute
    - » For now, the Colorado reporting requirement is on hold

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## Reporting Legislation (cont.)

- 2010
  - Oklahoma – H.B. 2359 (with affiliate bill), effective June 9, 2010
- 2011
  - South Dakota - S.B. 146 (with affiliate bill), effective July 1, 2011
  - Vermont - H.B. 436, effective May 24, 2011 (until click through effective)
- 2013
  - Kentucky - H.B. 440, effective July 1, 2013

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## Fulfillment Houses

- Fulfillment houses often are used by E-Commerce Businesses to provide services related to making sales.
- The extent of these services can range from shipping to customer service to taking orders to processing returns to storage of inventory.
- If the activity of the fulfillment house is limited to packing and shipping inventory not owned by the E-Commerce business, this won't create nexus in 21 states.

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## Fulfillment Houses (cont.)

- If the e-commerce business owns the inventory that will create nexus in the fulfillment house state in 11 more states.
- Almost every state has indicated that nexus is created when the Manufacturer performs significant fulfillment activities such as order and payment processing as well as the handling of product returns. In these cases, the fulfillment house is deemed the agent of the retailer.

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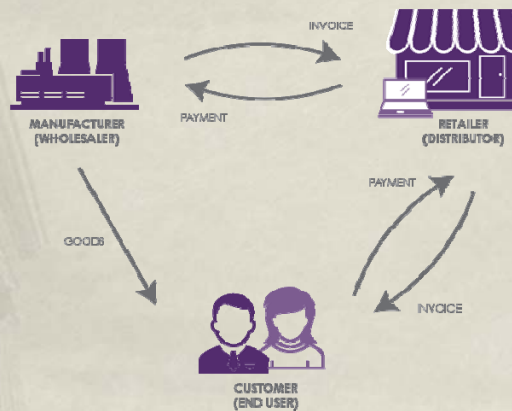


## Drop Shipments



## Drop Shipments

### THE DROP SHIPMENT MODEL



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## Drop Shipments (cont.)

- Will the state recognize the sale between the retailer (e-commerce business) and manufacturer as a sale for resale?
  - The transaction between the retailer and customer is the taxable retail transaction
  - There is no retail transaction between the manufacturer and customer
  - The transaction between the manufacturer and retailer is a transaction for resale

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## Drop Shipments (cont.)

BUT

- How do you claim a resale transaction?
- States require a valid resale exemption certificate for the ship to state
  - Should this be only a certificate for the ship to state?
  - What if the retailer isn't registered in the ship to state?
- What documentation will the state accept from the non-registered retailer?

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## Drop Shipments (cont.)

- Many jurisdictions will allow alternative documentation if a retailer is not registered
  - Written statement asserting retailer does not have nexus and is engaged in business of reselling (ID, LA)
  - Any documentation as long as it contains the required components i.e. retailer name, address, signature
  - Multi-jurisdictional certificate, Border States Uniform Sale for Resale Certificate, certificate from retailer's home state, SSTP certificate
  - SSTP States must accept alternative documentation

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## Drop Shipments (cont.)

- Some jurisdictions will accept another state's registration number on their own exemption certificate (NY)
- Retailer may be forced to register if the state only accepts its own registration number (CA)

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## Drop Shipments (cont.)

- What if the customer is reselling the goods?
  - If the state otherwise won't accept alternative documentation, if the customer is registered as a retailer, they may accept the customer's resale certificate (MA)
- What if the customer is an exempt entity?
  - Some states will allow a pass-through exemption if end customer is an exempt entity or also reselling (TN)

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## The Internet Tax Freedom Act



### What is the Internet Tax Freedom Act?

- The Internet Tax Freedom Act (signed into law in 1998) prohibited new taxes on Internet access fees. Most states do not tax the access fee.
- The Act did not prohibit states from imposing taxes on transactions conducted over the Internet.
- The use tax is not a discriminatory tax since it applies to all vendors (mail order, Internet, out-of-state, home shopping) and taxes goods purchased outside the state in the same manner as goods purchased in the state. So regardless of not being charged tax on an item purchased over the Internet, you are still held personally liable for the use tax.

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## What is the Internet Tax Freedom Act?

- The Act was set to expire on November 1, 2014.
- President Obama enacted legislation that extends the Act until October 1, 2015.
- On January 9, 2015, the House of Representative introduced a bill that would permanently extend the Act.
- Action is pending but it is expected to be extended if not permanently for a longer time frame

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## The Marketplace Fairness Act





## Marketplace Fairness Act of 2013 (H.R. 684 and S. 336; S.743)

- Would have authorized states that meet certain requirements to require remote sellers that do not meet a "small seller exception" to collect their state and local sales and use taxes
- \$1 million remote sales threshold
- SST States authorized automatically
- Other states must meet simplification requirements
- Passed by Senate May 6, 2013
- Failed to be enacted

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## Marketplace Fairness Act of 2013 (H.R. 684 and S. 336; S.743) (cont.)

- On September 18, 2013, the House Judiciary Committee released seven principles outlining priorities for the bill. The seven principles are:
  - Tax Relief
  - Tech neutrality
  - No regulation without representation
  - Simplicity
  - Tax competition
  - States' Rights
  - Privacy Rights

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## Marketplace Fairness Act of 2015

- On March 10, 2015, a bipartisan group of senators introduced the Marketplace Fairness Act of 2015. This is almost identical to the MFA of 2013
- On January 13, 2015, House Judiciary Chair Bob Goodlatte released a draft of the Online Sales Simplification Act of 2015
  - Proposes to use origin-based sourcing and does not include SST states among those authorized to impose collection requirements on remote sellers
- Representative Jason Chaffetz (R-UT) is drafting alternative federal legislation pertaining to remote sellers. The drafted legislation is not yet available for review.

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## Tangible vs. Digital Goods



## Tangible Personal Property

- Electronic commerce can be used to sell goods that are delivered tangibly. These items are taxed the same regardless of how delivered.
- The question with these types of transactions relate to whether the vendor is required to collect the tax.
- Goods purchased online but delivered tangibly are taxable unless statutorily exempt. If the vendor is not registered to collect the tax, the purchaser owes use tax.

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## Digital Goods

- This can include everything from computer software, ring tones, books, movies, music, greeting cards to database access and information services
- States vary as to whether they consider these items intangible goods, computer services, telecommunication service or digital goods. Some states may include some of these items in their definition of tangible property.
- SST States can not include digital goods in their definition of TPP and must separately impose tax on digital goods if they desire to tax it

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## Digital Goods (cont.)

- Software delivered electronically – includes software and applications that are downloaded onto the customer hardware
- Cloud-hosted software – also known as ASPs (Application Service Providers) - An entity retains custody over (or “hosts”) software for use by third parties.
- Data access – could vary depending on whether user has right to manipulate or download
- Information services – could vary depending on whether the information is personal and individual in nature (credit reports)

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## Digital Goods (cont.)

- SST definition of “specified digital products” means electronically transferred:
  - **“Digital Audio-Visual Works”** which means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.
  - **“Digital Audio Works”** which means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones.
  - **“Digital Books”** which means works that are generally recognized in the ordinary and usual sense as “books.”
  - For purposes of the definitions of specified digital products, “transferred electronically” means obtained by the purchaser by means other than tangible storage media.

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## Digital Goods (cont.)

- Taxability of digital goods varies based on the classification and where it is used/delivered/invoiced
  - Recent AZ decision that classified access to information service as rental of tangible personal property
- Sourcing for Digital Goods is problematic
  - Is it “used” at the server location or at the user location? Trend towards user location but this is problematic for the seller to know if not required under the contract.
  - Seller may not have any address information to use to determine sourcing
  - SST defines sourcing hierarchy with billing address acceptable if delivery or use address not know and seller address in last resort

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## Digital Goods (cont.)

- Contract/Invoice Language
  - How the item is described and defined can change the characterization
    - License vs Service
    - Access vs Download
    - Subscription vs Software

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## Resources

- CCH Drop Shipment Book -  
<http://www.yettertax.com/published/drop-shipments-taxation-compliance-and-planning-2012/>
- BNA 2015 Survey of State Tax Departments -  
<http://about.bna.com/2015-State-Tax-Survey>
- Tax on Software Database -  
<http://industrysalestax.com/>
- Amnesty Chart -  
<http://www.salestaxinstitute.com/resources/sales-tax-amnesty>

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## Tax Collection Tools



## Key Components of any Solution

- Sourcing/Jurisdiction Determination
- Taxability Determination
- Rate Determination
- Tax calculation
- Tax Posting
- Transaction Detail Reporting

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## Automated Solutions for Tax Determination

- Automated tax systems
  - Limit the risk of error
  - Consistent decisions are driven by automated generalizations
  - Tax Matrices
- Quotes vs Invoices for integration
  - Tax differences based on quote vs invoice dates
- Evaluate the cost
- Evaluation of Tax Software Functionality and Partners

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## Automated Tax Engine Solutions

- Rate only solutions
- Batch vs. Interactive (real-time) options
- External “bolt-on” solution to Webstore/ERP system
- Includes tax rates including effective dates
- Includes special rate rules like max taxes in most cases
- Many calculation solutions include taxability rules

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## Automated Tax Engine Solutions (cont.)

- Allow mapping of data elements to create tax rules
- Some solutions allow “if-then” rules to allow for assumptions when data is unavailable

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## Automated Tax Engine Solutions (cont.)

- Vendor Selection Considerations
  - Compatibility with your invoice/store system
  - Tax rule content for your industry
  - Hosted vs On-Premise
  - Pricing Model (fixed vs per transaction)
  - Compliance Options
  - Audit Support options

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## Automated Solutions Third Party Vendors – Tax Calculation Engines

- AccurateTax - [www.accuratetax.com/](http://www.accuratetax.com/)
- Avalara - [www.avalara.com/](http://www.avalara.com/)
- CCH – [www.cchgroup.com](http://www.cchgroup.com)
- Exactor - [www.exactor.com/](http://www.exactor.com/)
- EZtax (formerly BillSoft) – [www.eztax.com](http://www.eztax.com)
- FedTax (TaxCloud) - [www.taxcloud.net](http://www.taxcloud.net)
- Second Decimal - <http://www.seconddecimal.com/>
- Taxware - [www.taxware.com](http://www.taxware.com)
- Thomson Reuters/OneSource (including Sabrix) - <https://tax.thomsonreuters.com/products/brands/onesource/indirect-tax/>
- Vertex - [www.vertexinc.com](http://www.vertexinc.com)

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## Automated Solutions Third Party Vendors – Rates Packages

- AccurateTax - [www.accuratetax.com/](http://www.accuratetax.com/)
- BNA - [www.bnasoftware.com/](http://www.bnasoftware.com/)
- CCH - [www.cchgroup.com](http://www.cchgroup.com)
- Corptax - [www.corptax.com](http://www.corptax.com)
- Exactor - [www.exactor.com/](http://www.exactor.com/)
- EZtax (formerly BillSoft) - [www.eztax.com](http://www.eztax.com)
- FedTax (TaxCloud) - [www.taxcloud.net](http://www.taxcloud.net)
- Sales Tax Clearinghouse - [www.thestc.com](http://www.thestc.com)
- Tax Data Systems (acquired by Thomson Reuters) - <https://tax.thomsonreuters.com/products/brands/onesource/indirect-tax/rates>
- Taxware - [www.taxware.com](http://www.taxware.com)
- Thomson Reuters/OneSource (including Sabrix) - <https://tax.thomsonreuters.com/products/brands/onesource/indirect-tax/>
- Vertex - [www.vertexinc.com](http://www.vertexinc.com)

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