

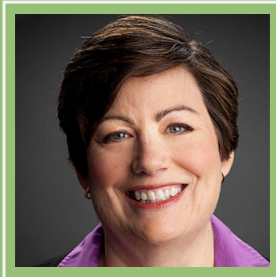
Drop Shipments: What Are They and What's New Post-Wayfair?



On-Demand Webinar

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- Accounting Today's 100 Most Influential People in Accounting for 2011, 2012, 2017, 2018 and 2019

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➤ Drop Shipment Definition

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Drop Shipment Definition

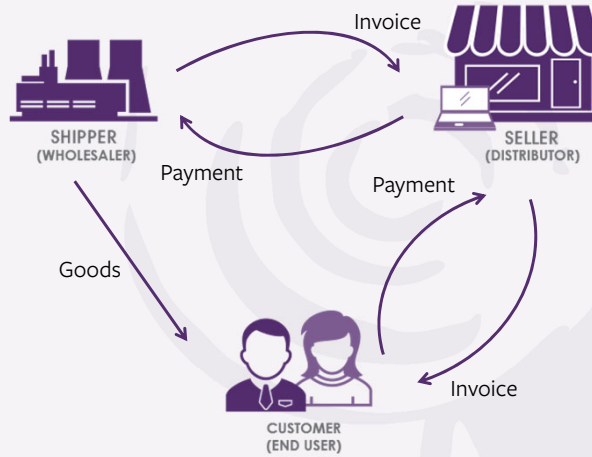
- Seller/distributor accepts order from customer/end user
- Seller/distributor places order with shipper/wholesaler
- Seller/distributor directs shipper/wholesaler to ship goods direct to customer/end user
- Shipper/wholesaler bills the Seller/distributor at wholesale price
- Seller/distributor bills customer at retail price

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Drop Shipments



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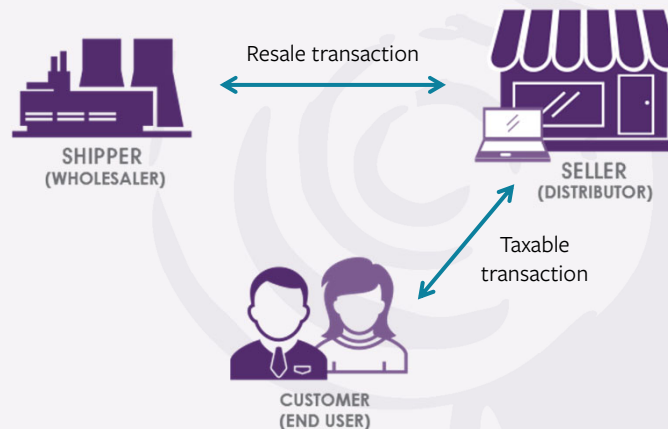
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➤ Sales Tax Treatment of Drop Shipments

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Implications of Drop Shipments



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Implications of Drop Shipments

- A state cannot require out-of-state businesses to register to collect its tax unless nexus is established
 - If the shipper/wholesaler requires appropriate exemption documentation, the retailer may be forced to register.
 - Otherwise the shipper/wholesaler will be required to charge tax on the invoice to the retailer.
 - Economic nexus could resolve many of these issues

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Sales and Use Tax Issues with Drop Shipments

- If the seller/distributor is not registered to collect sales tax and has no nexus with the state where the goods are shipped to the customer, will the state recognize the sale from the shipper/wholesaler to the retailer as a sale for resale?
 - The sale is a sale for resale, but the issue is how it can be documented

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Sales and Use Tax Issues with Drop Shipments (cont.)

- Does the answer change if the shipper/wholesaler delivers the goods in its own vehicles, rather than by common carrier or if the goods are shipped COD? Do the shipping terms affect the taxability of the transaction?
 - If delivery is made in the vendor's own truck, this is no longer an "interstate delivery" so some states won't accept alternative documentation (Florida and Kansas)

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Sales and Use Tax Issues with Drop Shipments (cont.)

- Does the answer change if the customer is reselling the goods, rather than using or consuming them?
 - Some states will accept a pass-through exemption if the end customer is reselling the goods purchased. (ex. California)
- Does the answer change if the customer is an exempt entity?
 - Some states will accept a pass-through exemption if the end customer is an exempt entity. (ex. Tennessee)

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Implications of Drop Shipments (cont.)

- What is the appropriate documentation to support the exempt transaction?
 - Some jurisdictions allow alternate documentation
 - Some states require their own registration number
 - Some states accept a pass-through exemption
- TOOL: Drop Ship Model and rules

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Implications of Drop Shipments (cont.)

- Tax collection issues
 - Is the in-state shipper/wholesaler considered a warehouse location for determining local tax rates on intrastate transactions?
 - Missouri considers the shipper location if located inside MO to be the origin of the sales and that the retailer must collect tax based on the shippers location and sales tax not seller's use tax applies

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Drop Shipment and Export

- Are export sales similar to drop shipments? If so, how? What documentation should you maintain for export sales?
 - Export sales may be similar to drop shipments if the goods are shipped to someone other than the purchaser
 - If the goods are shipped to an export broker address in a state hired by the customer, the seller should obtain the export documentation from the export broker or customer upon export
 - If the goods are picked up by the customer or the customers agent who is not an export broker, tax generally applies

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Dock Sales

- If the retailer's customer picks up the item at the dock, is it still considered a drop shipment?
 - It is deemed an in-state sale, so any states with inventory location rules will be impacted
 - Rules generally say "delivery" which doesn't necessarily mean "ship"
 - Lack of guidance on issue

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Sales and Use Tax Issues with Drop Shipments (cont.)

- Is Shipper/wholesaler required to collect tax?
 - What is the tax base?
 - Retail Price
 - Wholesale Price
 - California – if no certificate, collect tax on 110% of the price
 - Most other states say wholesale price unless they know the retail price
- If the shipper/wholesaler is required to collect tax from the seller/distributor, can the seller/distributor reimburse itself by passing the tax to the customer?
 - Usually no. It's a cost of goods sold.

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Tax Reimbursement

- Can an unregistered retailer reimburse itself by passing tax to customer? How can it be displayed? Does the sales tax reduce the use tax?
 - In California, if the seller does not hold a permit:
 - The shipper is responsible for reporting and paying the tax.
 - The shipper should charge the seller tax based on the retail amount.
 - The seller may choose to seek reimbursement from the customer on the sales tax either by increasing the selling price or adding a line on the invoice for reimbursement.
 - The seller cannot issue an invoice with a line called “California tax” or “California sales tax.” However, they may use a phrase such as “California tax paid to California drop shipper” or similar terminology, indicating that CA tax has been paid to the shipper.
 - (Publication 121, Drop Shipments, September 2018)

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Tax Reimbursement (cont.)

- Can an unregistered retailer reimburse itself by passing tax to customer? How can it be displayed? Does the sales tax reduce the use tax?
 - Connecticut indicates that the tax should be collected from the consumer rather than the retailer
 - Florida and Maryland allow the retailer to reimburse itself but can not show it as “tax” on the invoice
 - Michigan allows the retailer to indicate the tax is being passed through to the consumer and is not a tax being collected and remitted by the retailer, as the retailer is not registered for Michigan taxes.

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Streamlined Sales Tax Project Drop Shipments Issue Paper

- Under SSTP, member states must allow manufacturers to accept a resale exemption certificate from the retailer regardless of whether the retailer is registered to collect and remit sales and use taxes in the ship to state when the sale is made
- As a result, many member states have had to change their rules on what is considered acceptable documentation
- Tennessee will have to change once they become full member state
- https://www.streamlinedsalestax.org/docs/default-source/issue-papers/drop-shipments.pdf?sfvrsn=ebb98f41_4
 - Note that this paper is outdated as it relates to NE, NV, RI and WI which are now full member SST states

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Good Faith Acceptance

- If a vendor accepts a certificate adopted by the taxing authority, the vendor will be relieved of any tax liability and the Department may require a purchaser to validate the claimed deduction or exemption

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➤ Drop Shipments, Nexus, and Changes Post-Wayfair

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Drop Shipments and Nexus

- Businesses involved in drop shipment transactions may create tax collection and nexus issues as well
- “Click-Through” and affiliate nexus rules often apply in drop shipment business structures
- Unregistered retailers should not advertise that no sales tax applies on the orders
 - Notice & Reporting provisions may apply

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Drop Shipments and Nexus

- Use of 3rd party agents in the drop shipment business structure is often overlooked in determining where a retailer is required to be registered
- **Third-party logistics** (abbreviated as **3PL**, or TPL) in **logistics** and supply chain management is an organization's use of third-party businesses to outsource elements of its distribution, **warehousing**, and fulfillment services.
- Ownership of inventory at the fulfillment house will create nexus for retailer by the drop shipper
- Some fulfillment activities performed on behalf of the retailer may create nexus

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Drop Shipments and Nexus

- Use of 3rd party agents in the drop shipment business structure is often overlooked in determining where a retailer is required to be registered
- Third-party logistics (abbreviated as 3PL, or TPL) in logistics and supply chain management is an organization's use of third-party businesses to outsource elements of its distribution, warehousing, and fulfillment services.
- Ownership of inventory by the seller at the fulfillment house will create nexus for seller by the drop shipper

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Drop Shipments and Nexus

- True Wholesalers may now be deemed to have nexus after Wayfair and need to be diligent on getting all resale certificates.
- If they have nexus in states with restrictive exemption rules, they may need to register to collect tax if their customer can't provide the certificate with the right state number
- Wholesalers need to evaluate risk of non registering if sales exceed Gross sales thresholds

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Changes Post-Wayfair

- The South Dakota v. Wayfair decision could impact whether or not you need to register in some states.
- For states with economic nexus, be aware of how the state calculates the threshold (gross, taxable, or retail).
- The following states are restrictive:
 - California (gross sales)
 - Connecticut (gross sales)
 - District of Columbia (retail sales)
 - Hawaii (gross sales)
 - Maryland (gross sales)
 - Massachusetts (gross sales)
 - Mississippi (gross sales)
 - Tennessee (retail sales)

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Changes Post-Wayfair

- In all of the above states, make sure that you have resale certificates.
- In each state, it's important to get resale certificates if you are predominately wholesale. If you are exclusively wholesale and exceed the threshold, you may or may not need to actually register in the state.
- In “retail” states, if you are a wholesaler, only customers without valid resale certificates count toward the threshold.
- In “gross” states, if gross sales exceed the threshold, you have nexus and need to register if you need to obtain a valid state certificate.

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Drop Shipments and Marketplace Facilitation

- With marketplace facilitation, “seller” may not have reason to register as marketplace will collect
- Shipper may not have any indication sale is through a marketplace
- Challenges to the shipper as to what to accept if seller has no registration anywhere
- Does Marketplace Certification suffice?

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Drop Shipments and Marketplace Facilitation

- California new provisions allow a marketplace seller to provide a resale certificate in any form that contains all:
 - Name and address of purchaser
 - Purchaser's CA permit number **OR** if unregistered marketplace seller explanation that all sales are through registered facilitator with facilitator CA permit number
 - Description of property purchased
 - Statement that property is purchased for resale (must not say exempt or non taxable)
 - Date of document
 - Signature of purchaser
- CDTFA Tax Guide for Marketplace Facilitator Act-- Sales and use-- Introduction-- Nexus--Doing business in California-- Guidance on marketplace facilitator act, California (Aug. 1, 2019) <https://www.cdtfa.ca.gov/industry/MPFAct.htm>

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Registration Requirements vs. Filing "Zero" Returns

- Nexus vs Registration
 - Companies can have nexus but not have a registration requirement if they don't make taxable sales
 - Registration may be required in order to issue resale certificates
 - Registration may be required if your customer may not be able to issue you exemption certificates
- Be aware of the statute of limitations. If you aren't registered, there is no statute of limitations generally.

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➤ Practical Issues

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Practical Issues

- Manufacturers can be held liable for non collection of tax in states where they have nexus – should they require ship to state certificates?
- Retailers won't pay tax on items they buy for resale so if they are charged, they will short pay.
- How much time is spent trying to resolve these issues?

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Practical Issues

- How should you handle customers that refuse to pay the sales tax and cannot provide the required documentation?
- Do you credit the tax and reduce your taxable sales, or do you remit the tax to the appropriate jurisdiction?
 - Registered sellers that don't have appropriate exemption documentation should remit tax regardless of whether their customer paid it to minimize their audit risk and tax liability.

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Practical Issues

- Retailers are not required to register to collect tax if they don't have nexus.
- In states that require registration to issue a resale certificate, retailers may be "forced" to voluntarily register.
- What are the implications of voluntary registration?
 - You are required to collect and remit tax on ALL sales into that state.
 - You need to follow that state's laws.
 - You need to get appropriate exemption documentation on your customers.
 - You need to file returns.
 - You're subject to audit.
 - Bonding may be a requirement.

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Practical Issues

- In states that require the manufacturer to invoice the tax on a basis other than their selling price, how can they do this in their billing system?
 - Does the manufacturer know the retail selling price?
 - If there is a MSRP, but retailer can bill a different amount, what should the manufacturer use?
 - What if the known retail price is greater than 10% in California?

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Practical Issues

- Customers that accrue use tax on drop shipment purchases may end up paying use tax on an invoice that already includes some or all of the tax paid by the retailer. What should they do?
 - Do customers have the right to ask for documentation of tax paid?
 - Most states say that you can't ask for this documentation.
 - Will this documentation reduce their use tax obligation?
 - Most states say that it doesn't reduce the use tax obligation.
 - Should customers avoid purchasing where a drop shipment might apply if the retailer is not registered?
 - This can be a challenge. Doing price comparison shopping may be helpful.

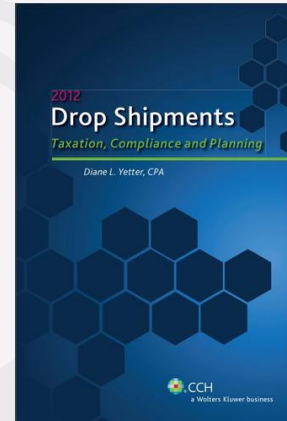
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CCH Drop Shipment Book

- CCH Drop Shipment book
 - <https://salestaxinstitute.redshelf.com/>
- May be unavailable after January 2020



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Questions/Comments

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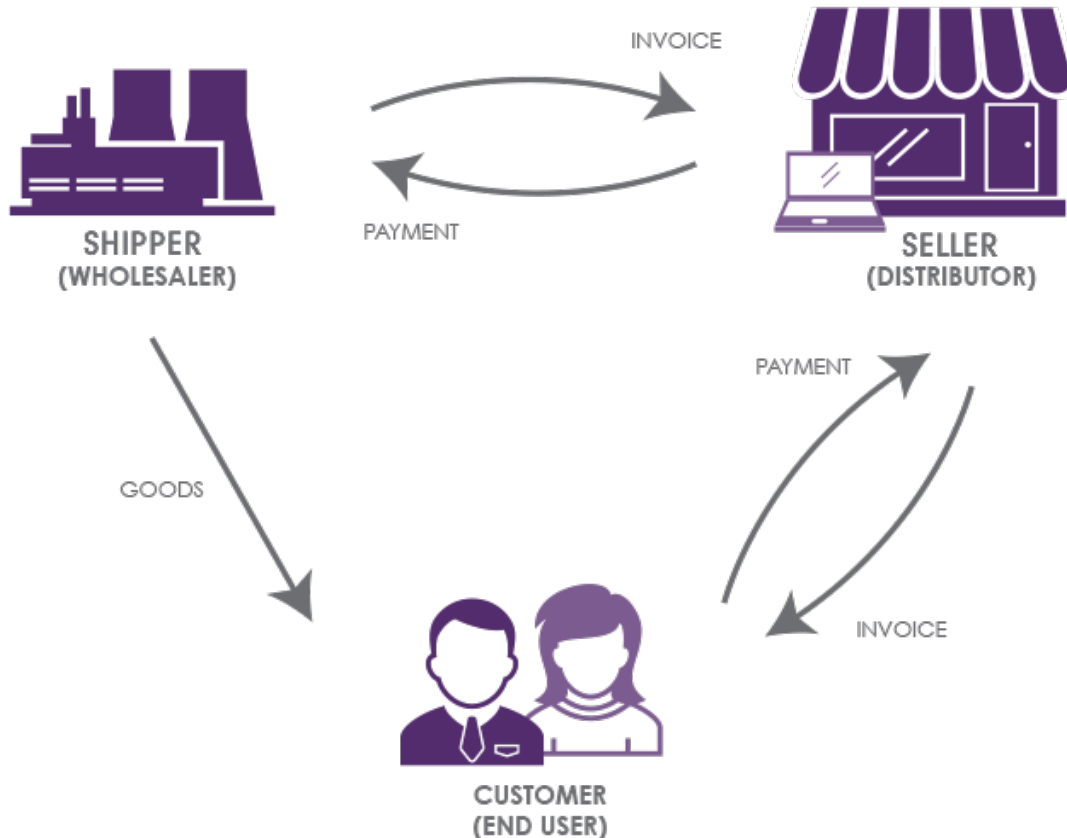
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The Drop Shipment Model



Drop Shipment Exemption Certificate Rules

You can use this document to determine what type of certificates can be used to claim a resale exemption on purchases that are drop shipped from a shipper to an end customer. If you are the shipper then this will tell you the type of documentation you can accept from your customer, the seller. If you are the seller, this will tell you what you need to give your supplier, the shipper.

For the seller's home state, they can use the specific state certificate or the multi-state certificate that is acceptable by that state using the home state registration number. This list represents the best answer for each state. However, for many of the states, they will accept something different. We recommend using the Streamlined Form as your first choice in the Streamlined states as it carries additional protections. It is always appropriate to issue the state specific certificate for states where you are registered.

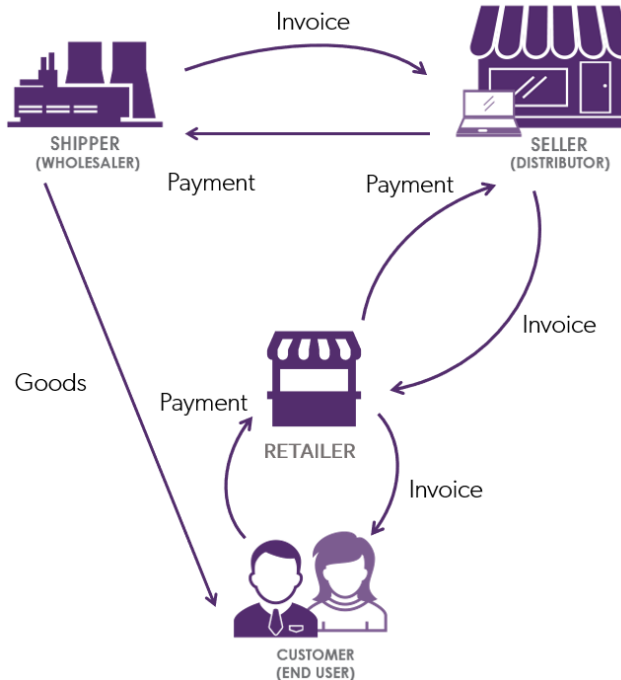
We've also provided you the links to the few certificates you will need other than your home state resale certificate which we assume you already have. If you want to include the following language in a cover letter/email to explain it might help:

Seller Company is purchasing products from Shipper Company for resale. The items are being drop shipped into states where Seller Company is not registered. Based on the laws in each state, we are providing you with documentation that qualifies as a valid resale certificate. These can include Seller's home state resale certificate, Seller's home state registration number on the SSTP or MTC Exemption Certificate, Seller's home state registration number on the ship to state certificate, or Seller's customer's resale certificate in their state in cases where Seller's customer is exempt in the ship to state.

1. States that accept the SSTP Exemption certificate with any state's registration number even if not Consumer State (Ship to State). Put Seller's home state sales tax number on each line labeled as "home state" (use Seller's actual home state name) Resale. Link to SSTP exemption certificate and instructions: <https://www.streamlinedsalestax.org/Shared-Pages/exemptions>
 - a. Arkansas
 - b. Georgia
 - c. Indiana
 - d. Iowa
 - e. Kansas
 - f. Kentucky
 - g. Michigan
 - h. Minnesota, as long as it contains the required information
 - i. Nebraska
 - j. Nevada
 - k. New Jersey
 - l. North Carolina
 - m. North Dakota
 - n. Ohio
 - o. Oklahoma
 - p. Rhode Island
 - q. South Dakota
 - r. Tennessee, effective 1/10/22 any state number accepted
 - s. Utah
 - t. Vermont
 - u. Washington
 - v. West Virginia
 - w. Wisconsin
 - x. Wyoming

2. States that accept the Multistate Tax Commission (MTC) Exemption certificate with any state's registration number even if not Consumer State (Ship to State). Put Seller's home state sales tax number on each line labeled as "home state" (use Seller's actual home state name) Resale unless otherwise indicated for the state below. Link to MTC exemption certificate and additional information: <http://www.mtc.gov/Resources/Uniform-Sales-Use-Tax-Exemption-Certificate>
 - a. Alaska
 - b. Arizona, if it contains the required information
 - c. Colorado
 - d. Florida, if wholesaler/shipper ships from non-FL inventory
 - e. Idaho, if Distributor/Seller does not have an Idaho seller's permit he should state that he has no nexus with Idaho on the certificate instead of listing Seller's home state number.
 - f. Illinois, put statement that there is no nexus in IL but seller is registered in "home state"

- g. Maine
 - h. Missouri
 - i. New Mexico
 - j. South Carolina
 - k. Texas
3. States that accept the home state resale certificate of Distributor/Seller. They should accept Seller's home state resale certificate for this state. For AL, you should indicate on your home state resale certificate that this should also be used to exempt drop shipments into AL.
- a. Alaska
 - b. Alabama
4. States that accept Ship to State resale certificate with Seller's home state registration number
- a. New York – link to New York State and Local Sales and Use Tax Resale Certificate (ST-120): https://www.tax.ny.gov/pdf/current_forms/st/st120_fill_in.pdf
 - i. Complete part 2
 - b. Virginia – link to Virginia Sales and Use Tax Certificate of Exemption (ST-10): <https://www.tax.virginia.gov/sites/default/files/taxforms/exemption-certificates/any/st-10-any.pdf>
 - i. On VA Account number line – write in “home state” and Seller's home state number
5. States where you will issue the ship to state certificate with a statement of no nexus in lieu of a number:
- a. Pennsylvania – link to Pennsylvania Exemption Certificate (REV-1220): <https://www.revenue.pa.gov/FormsandPublications/FormsforBusinesses/SUT/Documents/rev-1220.pdf>
 - b. Louisiana - Out of State non-registered Non-dealer Distributor/Sellers are required to document their non-dealer status in the records of the Wholesaler/shipper so Wholesaler/shipper will not be held liable for not having collected sales tax. The necessary documentation can be presented in letter format. Registered LA taxpayers should generate the form at <https://www.revenue.louisiana.gov/SalesTax/ResaleCertificate>



6. States where if Shipper is registered in the ship to state but Seller is not, but Seller's customer is a reseller and is registered or is otherwise exempt from tax. You will provide Seller's home state resale certificate with Seller's customer's certificate for the ship to state to Shipper with a note indicating that they are reselling or exempt and registered in the home state.
 - a. California (can use MTC form with CA number). Note that there is an exception for 100% marketplace sellers where the marketplace facilitator is required to collect and remit sales tax on the sales. <https://www.cdtfa.ca.gov/industry/MPFAct.htm#DropShipments>
 - b. Connecticut (can use MTC form with CT number)
 - c. Massachusetts (must use MA form <https://www.mass.gov/files/documents/2018/01/31/dor-sales-use-form-st-4.pdf>)
Note that a drop shipper may accept a notarized statement in lieu of a MA resale certificate and if marketplace sale, drop shipper can accept special marketplace facilitator form.
 - d. Mississippi (must provide MS certificate) – Note that Mississippi does not issue sales tax exemption or resale certificates.
 - e. Tennessee (can use SST or MTC form with TN number required through 1/09/22), if shipped from inventory within Tennessee

7. States where the only way to not pay tax to a registered Shipper for drop shipments into the state is for Seller to be registered and issue the ship to state certificate with the Seller's ship to state sales tax number.
 - a. Florida, if wholesaler/shipper ships from FL inventory
 - b. Hawaii – this will result in the wholesale rate of 0.005% instead of the retail rate of 4% (can use MTC form with HI number)
 - c. Maryland (can use MTC form with MD number)
 - d. Washington D.C. (must use DC certificate) – Link to District of Columbia Sales and Use Tax Certificate of Resale (OTR-368): <https://otr.cfo.dc.gov/sites/default/files/dc/sites/otr/publication/attachments/OTR-368%20CERT%20OF%20RESALE%2005.25.16.pdf>