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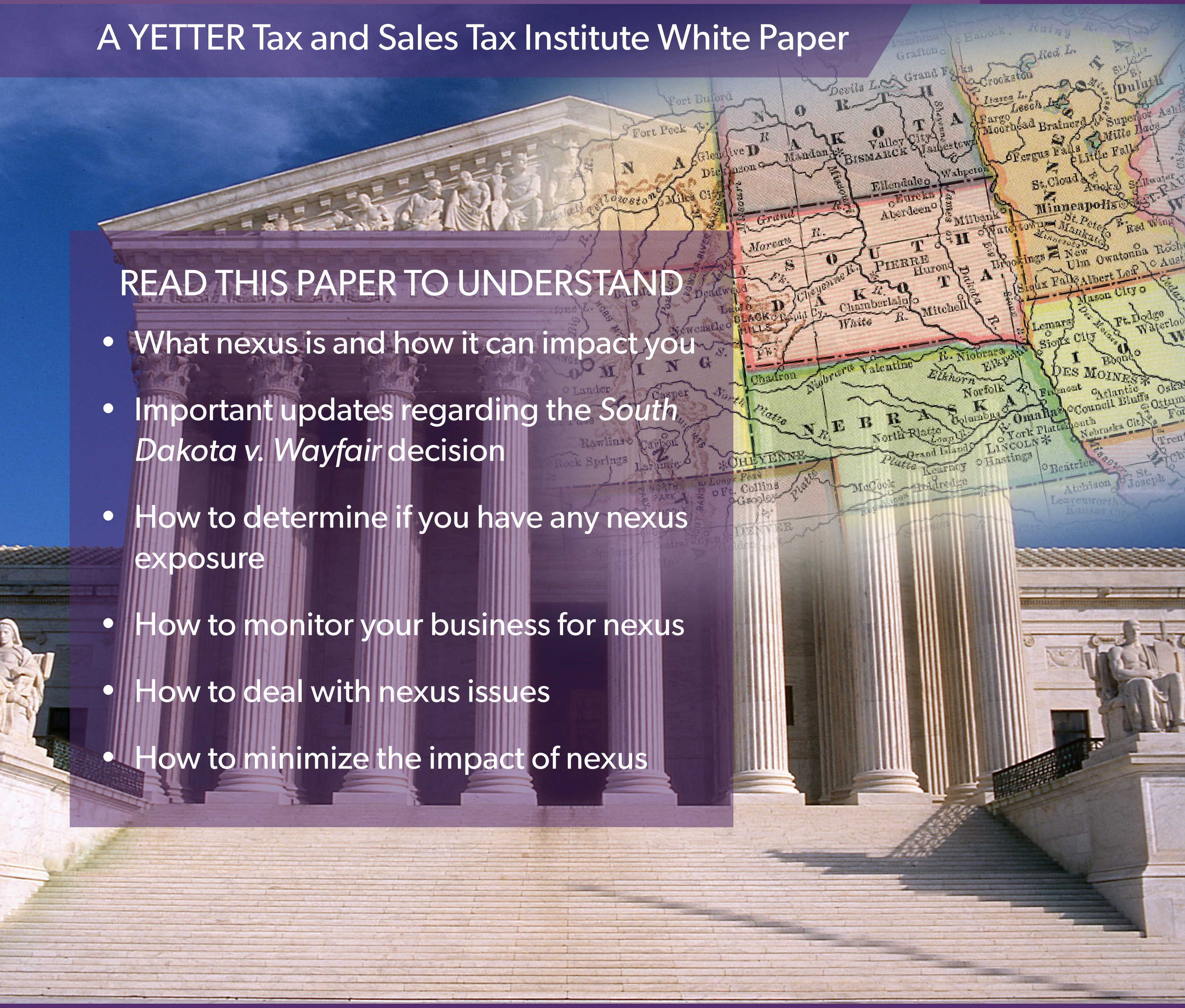
Nexus After *Wayfair* – What You Need to Know

A YETTER Tax and Sales Tax Institute White Paper



READ THIS PAPER TO UNDERSTAND

- What nexus is and how it can impact you
- Important updates regarding the *South Dakota v. Wayfair* decision
- How to determine if you have any nexus exposure
- How to monitor your business for nexus
- How to deal with nexus issues
- How to minimize the impact of nexus

Updated as of January 2020

INTRODUCTION

Nexus, Latin for a connection or common link, was never meant to be a threatening word. But for businesses today, the threat of creating sales tax nexus within a taxing jurisdiction has given the word a new and highly negative connotation. Small- to mid-sized and fast-growing companies in particular are in a double bind regarding sales tax nexus: they're big enough and busy enough to find themselves in the increasingly broad sights of state and local tax officials, but they typically lack the expertise and means to minimize their tax liability and audit exposure.

The complexities and fluidity of nexus coupled with the taxability challenges of what is sold can be overwhelming and require the constant attention of a tax expert to navigate, but most small- to mid-sized businesses cannot afford that kind of resource internally. Meanwhile, the penalties of under collecting, under reporting and underpaying can be huge—and there's rarely a statute of limitations, meaning states can go back for years to when you first established nexus to collect what's due if they discover you haven't properly met your sales and use tax obligations.

On top of all this, the U.S. Supreme Court issued a historic decision on June 21, 2018 in the *South Dakota v. Wayfair* case, which redefined nexus for out-of-state sellers. In a 5-4 decision, the Court ruled in favor of South Dakota and overruled *Quill Corp. v. North Dakota* and *National Bellas Hess, Inc. v. Department of Revenue of Ill*. The Court concluded that "the physical presence rule of Quill is unsound and incorrect." Quill had been the law of the land since 1992 regarding nexus for out-of-state sellers and *National Bellas Hess* since 1967, so this is a big deal for sales tax nexus.

If it is determined that you should have collected the tax from your customer, but you failed to, then you just reduced your profit margin. Sales taxes should not be a direct cost to a seller – rather sellers should act as an agent for the state. But, if you didn't collect the tax, the state can hold the seller liable in most cases. So, if you didn't collect the tax from your customer, you just increased your cost by the tax that you should have collected.

Can your business absorb the impact of an average tax rate of almost 10 percent? Even though sellers have the option to try to collect the back tax due from their customers, this isn't always successful –what if they are no longer a customer, out of business or just refuse to pay you years after the transaction occurred? Then there goes your profit. And that is just the tax amount. Add to this penalties and interest. Even if you survive an audit unscathed, the process itself can be a significant time and resource drain.

Additionally, revenue-hungry states are becoming increasingly aggressive in attempting to catch transgressors. But forewarned is forearmed. To help you reduce your exposure, this paper examines the significance and the vagaries of sales tax nexus. It discusses the activities that create nexus, what having nexus requires you to do, the key mistakes to avoid when completing a state nexus questionnaire, and how to deal with problems you may discover. It also covers the changes that have come about as a result of the U.S. Supreme Court's decision in *South Dakota v. Wayfair*. It concludes with our recommended course of action for dealing with sales tax nexus issues.

I. WHAT IS NEXUS… AND HOW CAN IT IMPACT YOU?

Sales tax nexus defines the level of connection between a taxing jurisdiction such as a state and an entity such as your business. Until this connection is established, the taxing jurisdiction cannot impose a sales tax collection responsibility on you. Nexus determination is primarily controlled by the U.S. Constitution, in which the Due Process Clause requires a definite link or minimal connection between a state and the entity it seeks to demand tax collection by, while the Commerce Clause requires that a seller must have a "substantial presence" in a state before the state can compel that seller to collect its taxes.

In the *Quill* case from 1992, the Court affirmed that in order to satisfy the Commerce Clause's "substantial presence" test, a state must be able to successfully assert that a seller has some form of "physical presence" within a state in order for the state to compel a seller to collect its taxes. Fast forward to 2018 and the *South Dakota v. Wayfair* case, where the Court held that the physical presence rule within the Commerce Clause established in the Quill case is no longer the sole means by which a state can assert sales tax nexus. The result is that while physical presence will still create nexus and is the first consideration in determining nexus, another path to sales tax nexus was established: economic nexus.

"Economic nexus" is a manner of establishing nexus solely based on the amount of economic activity a seller participates in, in any given state. The economic activity focused on by the Court in the *Wayfair* case was sales volume, measured by dollars or by number of sales transactions. As the case worked its way through the judicial system, and upon its eventual publication in 2018, many states enacted new types of economic nexus legislation to address how sellers conduct business today.

Given the states' ability to interpret Supreme Court decisions individually, there is not a uniform definition of nexus across the 50 states. That said, virtually all the sales tax states' nexus rules now seek to take advantage of the Court's decision in *Wayfair* to capture more sellers in their nexus net via economic nexus principles. Moreover, definitions and rules for determining nexus change constantly, and most states are careful to give themselves room to maneuver in their definitions. This means that a business must look at each state individually when determining sales tax nexus and must stay constantly on top of a slew of changing regulations and interpretations.

Here are a few representative definitions of Nexus that most states would more or less agree with. As you read them, you can almost feel the steel jaws starting to clamp around you:

- "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."
- "Any seller which does not have a physical presence in this state shall remit sales or use tax, if the seller meets either: 1. Gross sales from the sale of taxable items delivered in this state exceed $100,000; or 2. The seller sold taxable items for delivery in this state in 200 or more separate transactions

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The final example above describes economic nexus principles in action: nexus is created for any seller who meets certain sales volume, either measured in dollars or by number of transactions. Other states may set their own economic nexus thresholds based on sales volume and are only limited in their reach by the Court's admonition to not impede on nor create an undue burden on interstate commerce. South Dakota v. Wayfair established what would be considered acceptable to the Federal courts as being constitutional: $100,000 in annual sales to in-state customers or more than 200 separate sales transactions.

Therefore, a majority of states have set $100,000 in sales or 200 separate sales transactions as their economic nexus threshold. These definitions—which focus around having a business presence in a state—are just starting points for determining nexus. As we'll discuss, there are innumerable details, timescales, vagaries and state-by-state idiosyncrasies involved. But the point is, if you have knowingly or unknowingly created nexus in a state, then you are subject to some very strict obligations.

Implications of Nexus: What are your obligations?

If you have created sales tax nexus within a state or other jurisdiction, you are obliged to register as a retailer and collect and remit sales tax on all taxable sales into that jurisdiction. You are also obliged to obtain exemption certificates on all tax-exempt sales into the jurisdiction.

Nexus is also relevant to purchasers. If you have nexus in a jurisdiction and the seller didn't collect tax, you may be required to remit use tax on taxable purchases delivered within that jurisdiction. The obligation to remit use tax can extend to purchases of taxable advertising and promotional items (trade show giveaways, in-store handouts, etc.) that you might distribute in the jurisdiction.

As you might suspect, it is incumbent on you to understand your nexus situation in a timely and accurate fashion. Awareness of your nexus situation helps you identify your sales and use tax obligations; but even still, you are potentially subject to audits by the jurisdiction.

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Nexus Enforcement: Strong Arm of the Law

As federal funding to states has diminished and changes in how companies transact business occur, states have become much more aggressive in identifying and collecting all the tax revenue they can. They are looking harder for transgressors, hiring more tax auditors and sending their auditors out more frequently. The auditors are no longer restricted to audit in person since documentation can easily be sent across the internet and through secured state networks.

Auditors now have access to better tools and rely on upgraded internal systems that allow them to compare registrations across tax types and even checking registrations against companies that have contracts with the state or its agencies. States are also using their subpoena powers more frequently to obtain information about business partners of companies they are auditing as well as purchasing third party data for targeted industries they are focusing efforts on.

Here are some of the tools and tactics that states use to determine who to pursue and audit:

- **Nexus questionnaires** include questions about your company's activities in a given state and typically require a signature for proper submission. **Pennsylvania** has one of the most comprehensive questionnaires. States also periodically send out mass mailings indicating that the receiving company may be subject to reporting and collecting sales tax in the state. These mailings typically include nexus questionnaires that must be completed and returned promptly. Ignoring these questionnaires is not recommended because doing so can eliminate potential settlement options. Nexus questionnaires are designed to ferret out activities that a company may be engaging in within the state, and your answers can trigger further inquiries. Hence extreme care should be taken when responding to their questions. Seeking professional tax help is highly encouraged because simply checking "yes" to some questions can easily lead to a determination of nexus. If your activities in the jurisdiction are limited, it might be better to respond with a letter in lieu of completing the questionnaire. And don't wait to see if you get a second request! An unreturned nexus questionnaire or other mailer is a very obvious red flag in the state's eyes.
- **Nexus task forces** are state revenue department commando units. They are actively looking for companies with activities in the state to prove nexus. Among their hunting grounds are truck weigh stations, trade shows, large construction projects, and airports, harbors and even marinas. They don't even have to be out patrolling—they can sit back and conduct highly fruitful Web site and phone directory research as well.

- **Multi-State Tax Commission audits** are another way to get snared. The Multi-State Tax Commission has a joint audit program open to participating member states. Participating states nominate and vote on which companies to target, and the commission then conducts an audit on behalf of all the states concurrently. If you are registered in one or more of the participating states but not in all, this is a trigger to do a nexus audit for the unregistered states.
- **Audits of your customers and vendors** provide the states another net in which to ensnare you. During an audit of your customer, their supplier invoices will be reviewed as part of their use tax audit. If there have been charges for on-site services such as installation, consultation, training or repair work, that serves as proof that the vendor has had an in-state presence. In fact, a nexus questionnaire might not even be sent when an auditor discovers documentation of established nexus while conducting another company's audit– just a notice of an audit appointment. This could trigger nexus even if there isn't a separate charge for the services. Recall as well that with economic nexus principles now the norm, an auditor need not find documentation indicating a physical presence necessarily, only evidence of

significant sales volumes, either transaction count or total sales, can provide an auditor all they need to suspect you have nexus in their state and trigger an inquiry.

- Some states (such as California and Washington) have contacted sellers who make sales through Marketplace platforms such as Amazon, eBay, Etsy and regarding their sales tax obligations. A marketplace facilitator like Amazon may hold your inventory in their warehouse in a state which will trigger physical nexus and a requirement to register in those states. Generally, items can be transferred from one warehouse to another to fulfill stock level needs without notice being forwarded to the seller which can cause a nexus issue. If you are a fulfillment seller, monitoring the location of inventory is another important obligation for you.

II. DETERMINING YOUR NEXUS EXPOSURE

With taxing jurisdictions going all out to prove your nexus exposure, your first line of defense is to stay on top of the exposure yourself, so that you are not at risk of underreporting and underpaying taxes. The troublesome thing is, this is very hard to do across all states with a sales tax and other jurisdictions, especially given the complexity and changeability of the rules. There is one small relief: there are five states without a general sales tax: Alaska (but they have local taxes), Delaware, Montana, New Hampshire, and Oregon.

Pinpointing the Basic Activities that Create Nexus

The first step is to evaluate all the activities you are engaged in, in each jurisdiction where you do business and when the activities began. You will start with your physical activities and then evaluate your economic thresholds. If you have physical presence in the state, the economic thresholds are not relevant as you are deemed to have nexus based on your physical presence. During this review, you need to answer such fundamental questions as:

- Where do you maintain a permanent place of business? This includes corporate offices, sales offices, warehouses, manufacturing facilities, employee home offices and leased or rental property at customer locations.
- Where are you operating, or have you operated, a temporary place of business? This includes trade show booths and suites, sales meetings, training sites, and movable equipment at work sites. It can also include consigned inventory at a customer location or inventory held at a third-party fulfillment house (if you still own the inventory).
- Where do you have individuals permanently operating on your behalf? This includes administrative employees, employee salespeople, independent manufacturer representatives, service personnel, and agents. These individuals need not be employees to establish nexus for you!
- Where do you have individuals temporarily operating on your behalf? This includes traveling sales people, traveling independent representatives, traveling service personnel, owned delivery vehicles and agents.
- Where do you have individuals or companies who refer customers to your business via a link on their website or through other means and receive commissions for orders placed via those referrals? This can result in “click-through” nexus in states that have passed legislation. Note that you typically must meet a sales threshold in the state before click-through nexus applies. See the “New Concepts in Nexus Creation” section below for more information on “click-through” nexus.

- Where do you hold a substantial interest in, or are owned by, an in-state retailer and the retailer sells the same or a substantially similar line of products under the same or a similar business name, or the in-state facility/employee is used to advertise, promote, or facilitate sales to an in-state consumer? Or where do you have others (including independent individuals or companies) assisting in the facilitation of sales on behalf of your business such as handling delivery, installation or other sales related activities? This can result in "affiliate" nexus in states that have passed legislation. See the "New Concepts in Nexus Creation" section below for more information on "affiliate" nexus.
- As an out-of-state seller, do you meet or exceed a specified amount or number of sales into a state that has enacted economic nexus legislation? See the "New Concepts in Nexus Creation" section below for more information on economic nexus.

For an up-to-date list of states that have passed remote seller nexus laws, visit our **Remote Seller Nexus Chart**.

New Concepts in Nexus Creation

With the changing marketplace and new ways of selling goods, the traditional definition of nexus has been expanded through new kinds of nexus legislation enacted in many states. These new types of nexus include click-through, affiliate, economic and marketplace nexus. Additionally, some states have enacted notice and reporting requirements for remote sellers making sales into their states that are not otherwise registered to collect tax.

Click-Through Nexus

Click-through nexus legislation can vary by state but typically has a few specific attributes. If a retailer or service provider contracts with an individual or business located in-state who directly or indirectly refers potential customers to the retailer through a web link or other means for a commission or other consideration upon sale, the retailer is considered to maintain a place of business in that state. With click-through nexus, a sales threshold typically applies: the cumulative gross sales by the retailer to customers in-state referred through this type of agreement during the preceding four quarterly periods must exceed a certain amount in order for the retailer to qualify and be considered to have nexus in the state. The most common threshold of referred sales is $10,000 per year.

New York was the first state to enact click-through legislation, in 2008. Amazon.com and Overstock.com filed lawsuits against New York claiming that the legislation was unconstitutional. The New York Supreme Court held that there was no basis upon which Amazon.com or Overstock.com could prevail and dismissed the cases. Both companies appealed their respective decisions, and on November 4, 2010, the Appellate Division reinstated their complaints. On March 28, 2013 the Court of Appeals of New York found the statute constitutional. On

August 23, 2013, Amazon.com and Overstock.com asked the U.S. Supreme Court to review the Court of Appeals of New York ruling. On December 2, 2013, the U.S. Supreme Court denied the requests to review the ruling. Based on this, the New York law stands, and this became the nexus standard within New York. Most of the other states that have enacted click through nexus have similar legislation as New York and therefore would likely also be found constitutional upon challenge.

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Illinois differed in their enacted click-through nexus legislation in 2011. They had a minor difference in their provision. A lawsuit was filed by the Performance Marketing Association claiming that the legislation was unconstitutional. The legislation was ruled unconstitutional by the Circuit Court of Cook County on May 7, 2012. On October 18, 2013, the Illinois Supreme Court upheld the lower court's ruling and ruled that the click-through law is pre-empted by federal law, specifically the Internet Tax Freedom Act. This was based on the fact that the click through nexus provision only applied for web marketing and not any other type of marketing relationships.

A new click-through bill, S.B. 352, was passed by the Illinois House and Senate on May 30, 2014 and signed by the governor. This revised provision was effective January 1, 2015. The new bill broadened the activities that can create nexus by including non-internet activities to satisfy the Illinois Supreme Court's ruling that the statute violated the Internet Tax Freedom Act. Note that Illinois enacted legislation that repealed the state's click-through nexus provisions, effective June 28, 2019.

However, this was re-enacted with bill S.B. 119, effective January 1, 2020. Some other states with click through nexus have repealed the provisions believing their economic nexus provisions provide a broad enough nexus definition.

Affiliate Nexus

Affiliate nexus is created when an affiliated person of the retailer with a physical presence, or employees or agents in state, has sufficient nexus in a state to require the retailer to collect and remit sales and use taxes on taxable retail sales in that state. Illinois and Arkansas were the first states to enact affiliate nexus in 2011. Note that Illinois repealed its affiliate nexus provisions, effective June 28, 2019 but this was also re-enacted effective retroactively to July 1, 2011 in November 2019 (S.B. 119). A number of additional states including Arkansas repealed affiliate nexus provisions based on the enactment of economic nexus legislation in 2019.

Typical attributes of affiliate nexus legislation include: the retailer holds a substantial interest in, or is owned by, an in-state retailer and the retailer sells the same or a substantially similar line of products under the same or a similar business name, or the in-state facility/employee is used to advertise, promote, or facilitate sales to an in-state consumer. The provisions may not always require common ownership. It may include activities related to sales, delivery, service and maintaining a place of business in the state on behalf of the out of state business to benefit the out of state business' customers. It may also include sharing management, business systems, business practices, or employees with the retailer, or engaging in intercompany transactions with the retailer related to the activities that establish or maintain the retailer's market in-state. There are no sales threshold or activity thresholds that apply under affiliate nexus.

Economic Nexus

Economic nexus legislation is the more recent and significant development. Under economic nexus legislation, if an out-of-state seller exceeds a specified economic threshold in the state, then the seller has nexus in the state and must collect and remit sales tax in that state. The economic threshold may be based on amount of taxable sales made in the state, gross income in the state, a number of transactions in the state, or other thresholds.

One of the first states to enact economic nexus was South Dakota in 2016. The legislation required all retailers subject to the tax to register as of a date certain and if they didn't, it allowed the state to sue them. This offered an expedited approach to litigation to address the constitutionality of the law. South Dakota sued three retailers – Wayfair, Overstock.com and Newegg. Since the nexus standard at this time was "substantial physical presence", the state knew it would be found unconstitutional and therefore it requested summary judgement declaring the economic nexus statute unconstitutional. On March 6, 2017, the South Dakota Sixth Judicial Court ruled that the state's economic nexus legislation is unconstitutional. In the ruling, the state acknowledged that under *Quill Corp. v. North Dakota*, the State of South Dakota is prohibited from imposing the sales tax collection and remittance obligations. (*South Dakota v. Wayfair, Inc.*, S.D. Cir. Ct., No. 32 Civ. 16-000092, 3 / 6 / 17).

The state appealed the decision to advance the case through the courts with the ultimate goal of an appeal to the U.S. Supreme Court. On September 13, 2017, the South Dakota Supreme Court struck down the state's economic nexus legislation, concurring with the South Dakota Sixth Judicial Court's ruling that the legislation conflicts with *Quill Corp. v. North Dakota* and is unconstitutional (*South Dakota v. Wayfair, Inc.*, South Dakota Supreme Court, No. 28160, September 13, 2017).

On October 2, 2017, South Dakota filed a petition for certiorari with the U.S. Supreme Court to hear *South Dakota v. Wayfair, Inc.* in an effort to overturn *Quill Corp. v. North Dakota* (South Dakota, *Petitioner*, v. Wayfair, Inc., Overstock.com, Inc., and Newegg, Inc. *Respondents*. In the Supreme Court of the United States On Petition for a Writ of Certiorari to the Supreme Court of South Dakota). On January 12, 2018, the U.S. Supreme Court agreed to take up *South Dakota v. Wayfair* and on April 17, 2018, the Court heard oral arguments.

On June 21, 2018, the U.S. Supreme Court issued its decision in South Dakota v. Wayfair. In a 5-4 decision, the Court ruled in favor of South Dakota and overruled *Quill Corp. v. North Dakota* and *National Bellas Hess, Inc. v. Department of Revenue of Ill*. The Court concluded that "the physical presence rule of *Quill* is unsound and incorrect." In the opinion of the Court, Justice Kennedy wrote that "Modern e-commerce does not align analytically with a test that relies on the sort of physical presence defined in *Quill*." Although the decision found in favor of South Dakota, it was also remanded to the South Dakota Supreme Court to evaluate if the provision meets the other tests for constitutionality.

The Court concluded that "the physical presence rule of Quill is unsound and incorrect."

As part of the original South Dakota legislation, once litigation commenced against any party, the state was prohibited from enforcing the economic legislation against any seller. Therefore, even though South Dakota won the case, they were prohibited from enforcing it due to the remand from the Supreme Court. Following a special legislative session on September 12, 2018, South Dakota Gov. Dennis Daugaard signed into law a measure that dissolves and lifts the injunction against the collection of sales tax on remote sales. The measure, Senate

Bill 1, was effective November 1, 2018 and allowed the state to begin collecting tax from remote sellers who meet the state's economic nexus threshold. This legislative change removes the stay except for the parties to the case. The governor also signed Senate Bill 2, which requires marketplace providers to obtain a sales tax license and collect and remit sales tax on behalf of sellers using their platforms. No marketplace provider is required to collect or remit sales tax under this Act on any sale made before March 1, 2019.

The Court's decision in *South Dakota v. Wayfair* is significant since *Quill* had been the law of the land since 1992 regarding nexus for remote sellers and *National Bellas Hess* since 1967! In the wake of the Court's decision, a number of states that had previously enacted economic nexus legislation addressed the decision and announced the effective date for their legislation (which in some cases, was pending the *South Dakota v. Wayfair* decision).

After the Court issued its *South Dakota v. Wayfair* decision, Hawaii, Maine, and Vermont were the first to issue notices announcing that their economic nexus provisions are effective July 1, 2018. Additional states announced effective dates throughout the rest of 2018 into 2019.

Most of the remaining states enacted economic nexus legislation. However, a few including Michigan, New York, North Carolina, and Wisconsin took the position that they had statutes in place that permit them to enforce economic nexus. Language in their definition of retailer engaged in business included phrases such as "as authorized under the US Constitution". These states believe this permits them to adopt policy positions for economic thresholds without specific economic legislation. These states have released bulletins or administrative regulations discussing their thresholds and effective dates. North Carolina later enacted legislation codifying the economic nexus provisions that the state previously issued in a policy directive. The effective date for the enacted legislation is March 20, 2019 (Ch. 6 (S.B. 56), Laws 2019). Per the state's earlier policy directive, North Carolina has been enforcing the economic nexus provisions effective November 1, 2018. Michigan also codified their administrative position in H.B. 4542 and H.B. 4543 which were effective retroactively to October 1, 2018. New York announced in a notice on January 14, 2019 that it was enforcing its legislation which has a $300,000 AND 100 transaction threshold retroactively since the Wayfair decision on June 21, 2018. It later enacted S.B. 6615 which raised the economic threshold to $500,000 AND 100 transactions which was signed on June 24, 2019. Wisconsin enacted S.B. 883 codifying its $100,000 or 200 transaction threshold on December 14, 2018.

Kansas is the only state that didn't enact legislation to enforce economic nexus but also relied on existing legislation. In fact, it is also the only state that does not have a smaller seller exception based on either sales or transaction thresholds. On August 1, 2019, the Kansas Department of Revenue released a notice stating that any remote seller that sells tangible personal property or services into Kansas must register and collect sales or use tax by October 1, 2019. The notice relies on K.S.A. 79-3702(h)(1)(F) which provides that any retailer that has contact with Kansas is considered "doing business in the state" and allows the state to require collection by all sellers. The Kansas Attorney General issued an opinion On September 30, 2019 expressing his opinion that this provision is invalid. However, the Secretary of Revenue indicated that the Department would enforce the policy unless a court rules against the policy. To date, no legal actions have been filed challenging the notice.

All the other states that had litigation pending due to their economic nexus provisions having effective dates prior to the *Wayfair* decision were resolved, typically through a dismissal process. These states include Alabama, Indiana, Tennessee, and Wyoming. Their effective dates varied depending on the effort to resolve their legislation. Tennessee's litigation was based on a regulation and not legislation and so the state enacted legislation on May 21, 2019 that authorized the DOR to enforce its economic nexus rule, effective July 1, 2019. Tennessee later released Notice #19-04 which states that out-of-state dealers with no physical presence in Tennessee who meet the state's economic nexus threshold as of July 31, 2019 must register and begin collecting Tennessee sales and use tax by October 1, 2019 under a revised threshold of $500,000.

[Massachusetts and Ohio] defined physical presence to include digital presence such as a digital "cookie" or software or apps downloaded onto devices in their state to constitute physical presence.

Two states, Massachusetts and Ohio, took a different approach and enacted a type of "physical presence" rule before the *Wayfair* decision was issued. These states defined physical presence to include digital presence such as a digital "cookie" or software or apps downloaded onto devices in their state to constitute physical presence. Since this is based on a physical presence in the state, they took the position that the *Wayfair* decision has no impact on their provisions. Both states included a sales threshold of $500,000 (and 100 or more transactions for Massachusetts) in addition to the "cookie" presence in their provisions. Massachusetts applied these rules through amendments to their regulations while Ohio did it through legislation.

Due to challenges raised to the language in the original Directive and the fact that there was no legislation or regulation, on June 28, 2017, the Massachusetts Department of Revenue issued Directive 17-2, which revoked the state's economic nexus directive (Directive 17-1: Requirement that Out-of-State Internet Vendors with Significant Massachusetts Sales Must Collect Sales or Use Tax), effective immediately (Directive 17-2: Revocation of DD 17-1 In Anticipation of a Proposed Regulation). On September 22, 2017, the Massachusetts Department of Revenue finalized the state's new economic nexus regulation. The final regulation took effect October 1, 2017. (830 CMR 64H.1.7: Vendors Making Internet Sales) which defined nexus to include the digital physical presence. A number of challenges to the regulation were filed both before and after the *Wayfair* decision.

The Massachusetts Superior Court dismissed a lawsuit filed by online retailers regarding retroactive application of the state's economic nexus regulation. The lawsuit regarded the application of the economic nexus standard from October 1, 2017 – when Massachusetts enacted its economic nexus regulation – to June 21, 2018, when the U.S. Supreme Court handed down its decision in *South Dakota v. Wayfair*. (*Blue Nile LLC et al. v. Christopher C. Harding, Commissioner of the Massachusetts Department of Revenue*, case number 1884CV03934-BLS1, in Massachusetts Superior Court, Suffolk County)

On October 24, 2017, Crutchfield Corp., a Virginia-based online retailer, filed a lawsuit in the Virginia courts challenging the validity, enforceability and constitutionality of the Massachusetts economic nexus regulation (*Crutchfield Corp. v. Harding*, Va. Cir. Ct., No. CL17001145-00, 10/24/17). On June 22, 2018, Massachusetts issued a news release saying that the existing regulation continues to apply and is not affected by the Supreme Court's decision in *South Dakota v. Wayfair*. In an October 9, 2019 letter opinion, Virginia's 16th Judicial Circuit granted the motion to dismiss filed by Massachusetts revenue officials in the *Crutchfield Corp. v. Harding* case, holding that the court lacked jurisdiction over Crutchfield's challenge to Massachusetts' economic nexus regulation (*Crutchfield v. Commonwealth of Massachusetts*, October 9, 2019).

Effective October 1, 2019, Massachusetts enacted legislation that creates new requirements for remote retailers and marketplace facilitators. A remote retailer or marketplace facilitator is required to collect and remit tax if its sales within Massachusetts in the prior or current taxable year exceed $100,000 (previously $500,000 and 100 transactions). The state also has emergency and proposed regulations that repeal the cookie nexus provision as of October 1, 2019. (H. 4000, Laws 2019)

The Ohio legislation, effective January 1, 2018, was also challenged in court. (Sec. 5741.01(I)(2) American Catalog Mailers Association v. Joseph W. Testa, Tax Commissioner, et al, No. 17CV011440, 12/29/17). On December 18, 2018, the American Catalog Mailers Association voluntarily withdrew its lawsuit challenging Ohio's economic nexus legislation (*American Catalog Mailers Association v. Joseph W. Testa,* Franklin Cty., Ohio Ct. Com. Pl., No. 17-CV-11440, voluntary dismissal 12/18/18). Ohio passed new economic nexus provisions, effective August 1, 2019. The legislation changes the economic threshold from $500,000 to $100,000 or 200 transactions. The law also repeals Ohio's provisions relating to software (cookie) nexus as well as click-through and affiliate nexus (*Amended Sub. H.B. 166*, Laws 2019)

The Washington Business and Occupation Tax is not a sales tax but a gross receipts tax which was not impacted by the Quill physical presence requirements. The legislation imposes Business and Occupation tax on all types of businesses, not just those make retail sales. For businesses that exceeded an economic nexus threshold which as varied over the years. New provisions were enacted effective July 1, 2017 which applied to retail sales and the sales threshold was $267,000 of gross receipts in 2016. The gross receipts threshold includes an inflationary adjustment and the threshold was $285,000 for 2017 and 2018. Washington added the sales tax economic nexus threshold of $100,000 or 200 transactions effective October 1, 2018. On March 14, 2019, Washington Gov. Jay Inslee signed legislation (S.B. 5581) which contained numerous changes to the state's remote seller nexus provisions. Effective January 1, 2020, the economic nexus threshold for Washington business and occupation (B&O) tax purposes is $100,000 in cumulative gross receipts in Washington. The legislation also removes the 200 transaction threshold for remote sellers for sales tax economic nexus effective March 14, 2019.

Marketplace Nexus

Marketplace facilitation legislation is the states' attempts to remove collection burdens and responsibilities from small sellers that sell predominately or exclusively on marketplace forums. This type of legislation requires marketplace facilitators like Amazon, eBay, Etsy, Walmart, and others to collect tax on behalf of all sellers selling through their systems. New York initially attempted to pass this type of nexus legislation in 2015 but failed. New York eventually passed marketplace nexus provisions, effective June 1, 2019, as part of its 2019-2020 budget package.

> **[Marketplace] legislation requires marketplace facilitators like Amazon, eBay, Etsy, Walmart, and others to collect tax on behalf of all sellers selling through their systems.**

The enactment of marketplace facilitation collection provisions has created challenges and benefits to some remote sellers. For larger sellers that sell multi-channel, the exclusion of marketplace sales from their sales tax returns can be problematic. In many cases, the sales are included in their sales systems, particularly for self-fulfilled sales. Excluding these sales requires customization to the sales systems and challenges to reconciliation. A few states have included provisions allowing the seller and marketplace to negotiate who will be responsible for the remittance of the tax.

For smaller sellers, the marketplace facilitation legislation has eliminated their requirements to be registered. A number of the states have modified their threshold tests to eliminate any sales that are remitted by a marketplace facilitator. For sellers that sell exclusively on marketplaces that comply, this has eliminated the need to be registered.

For an updated list of the states that have enacted marketplace nexus legislation and their effective dates, visit our **Remote Seller Nexus Chart**.

These provisions do remove the burden of collection and reporting from individual sellers. However, not all the states have consistent provisions, which adds complexity to the situation. In response to the inconsistency, the Multistate Tax Commission formed a workgroup to review the issues and has issued white papers to provide best practices to states that are looking to enact similar provisions.

For documentation regarding the workgroup, please visit the **MTC Workgroup page**. In addition, the National Conference for State Legislatures has drafted model legislation for states to consider as the enact or modify their legislation.

Notice and Reporting Requirements

Prior to any state enacting economic nexus provisions, states attempted to enforce provisions that were discussed in the *Quill* decision by enacting Notice and Reporting provisions. In the *Quill* decision, the Court distinguished the Commerce Clause which required substantial physical presence from the Due Process Clause which only required a minimal connection between the seller and the state. In the decision, the Court restricted the ability for states to require tax collection by sellers to those that exceed the substantial physical presence under the Commerce Clause. However, it did permit the states to require sellers to provide information about its customers if they exceed the Due Process Clause minimal connection threshold. Although the Quill decision was issued in 1992, little movement under this interpretation happened until 2010.

Under Notice and Reporting legislation, remote sellers who are not required to register and collect sales tax are obligated to notify their customers of their use tax obligation. This requirement varies from a simple prohibition of advertising that no tax applies and the inclusion of a notice regarding consumer's use tax obligations on web pages and order platforms to on invoice notifications, annual reports sent to customers with details of their purchases and even submitting customer information to the states to allow them to purse the collection of use tax from the customers. Even without legislation prohibiting it, retailers should not advertise or promote that sales tax does not apply. It is a recommended best practice to include information on the order mechanism (catalog or web page) notifying the customer where the retailer is registered to collect tax and if purchases are made for delivery into other states that the customer has a use tax obligation.

Under Notice and Reporting legislation, remote sellers who are not required to register and collect sales tax are obligated to notify their customers of their use tax obligation.

Colorado was the first state to enact reporting requirements legislation, in 2010. A lawsuit was filed by the Direct Marketing Association, claiming that the legislation was unconstitutional. On January 26, 2011, the U.S. District Court for the District of Colorado enjoined the Colorado Department of Revenue from enforcing its sales/use tax notice and reporting requirements on out-of-state retailers. On March 30, 2012, the U.S. District Court for the District of Colorado issued a permanent injunction against the reporting requirements, declaring them unconstitutional. The U.S. District Court of Appeals for the 10th Circuit ruled that the lower federal court overstepped its jurisdiction when it declared the provision unconstitutional and issued a permanent injunction against the reporting requirements. The U.S. Court of Appeals remanded the case to

the federal district court to dismiss the plaintiff's claims and to lift the permanent injunction.

In a parallel action in the federal courts, on December 13, 2013, a federal district court judge issued an order dissolving the permanent injunction entered against the Colorado Department of Revenue regarding the requirements. On February 19, 2014, a Denver district court judge granted Direct Marketing Association's motion for a preliminary injunction against Colorado imposing the requirements. The U.S. Supreme Court was asked to review the decision by the U.S. District Court of Appeals for the 10th Circuit and agreed to review the decision. The issue brought to the U.S. Supreme Court wasn't whether the statute was constitutional but rather whether the issue could be heard in the federal courts. On March 3, 2015, the U.S. Supreme Court held that a federal district court has jurisdiction over the lawsuit challenging the constitutionality of Colorado's reporting requirements legislation for out-of-state retailers and may enjoin enforcement of the requirements.

On February 22, 2016, the Tenth Circuit Court of Appeals issued their final decision in *Direct Marketing. Association v. Colorado Department of Revenue*, (Colo. Dist. Ct., No. 13-

CV-34855). The court held that the law does not violate the dormant Commerce Clause because it does not discriminate against or unduly burden interstate commerce. The court's decision reversed the district court's order granting summary judgment and remanded for further proceedings consistent with this opinion. On August 29, 2016, DMA filed a petition for writ of certiorari in the U.S. Supreme Court seeking review of the Tenth Circuit Court of Appeals decision. On December 12, 2016, the U.S. Supreme Court declined to review the ruling of the U.S. Court of Appeals for the Tenth Circuit that upheld Colorado's use tax notice and reporting requirements.

On February 23, 2017, it was announced that the Direct Marketing Association reached a settlement agreement with the Colorado Department Revenue in regards to its lawsuit over the state's use tax notice and reporting requirements. Pursuant to the settlement agreement, Colorado's use tax notice and reporting requirements legislation became effective on July 1, 2017. Non-collecting retailers are required to include the required transactional notices on all invoices issued after July 1, 2017. The first annual summaries of customer purchases required of non-collecting retailers were required to be mailed to customers by January 31, 2018. The first customer information reports required of non-collecting retailers were required to be filed with the Department by March 1, 2018.

Based on this decision, a number of additional states passed various types of notice and reporting legislation. A few states including Washington, Pennsylvania, Oklahoma, Vermont, and Rhode Island, took a more aggressive position with their legislation than Colorado did. These states set a notice and reporting threshold at a very low level (typically around $10,000) with an alternative to collect the tax. These are technically not "economic nexus" provisions but did have the effect the states desired of sellers collecting tax rather than comply with the notice and reporting requirements. In fact, the largest online marketplaces registered to collect tax rather than comply with these reporting requirements and also began collecting on behalf of their third-party sellers as these provisions would have required the marketplace to report on all third-party sales also. Shortly after the *Wayfair* decision, Rhode Island which had passed economic or reporting legislation effective August 17, 2017, issued a press release reminding remote sellers about their registration options. Although the economic nexus could not technically be enforced prior to the decision, the reporting requirement could.

As economic nexus legislation has become the norm across the states in the wake of the South Dakota v. Wayfair decision, the enactment of notice and reporting requirements legislation across the states has become less prevalent and some of the states have subsequently repealed their provisions.

To stay up-to-date on enacted remote seller nexus legislation of all types, visit our **Remote Seller Nexus Chart**. For additional state resources pertaining to remote seller nexus legislation, visit our **Remote Seller Resources page**.

Federal Legislation

Prior to any state proposing or enacting economic nexus legislation, efforts were focused on federal legislation. Bills have been proposed for decades that would invalidate the physical presence requirement determined in the *National Bellas Hess* and *Quill* cases. The Streamlined Sales Tax Project has had federal legislation as one of its goals. There has been limited success in these endeavors until the Marketplace Fairness Act of 2013. This would have authorized states that meet certain requirements (basically Streamlined Sales Tax Full Member states) to require remote sellers that do not meet a ″small seller exception″ to collect and remit their state and local sales and use taxes. The legislation was introduced on February

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14, 2013 in both the US House and Senate. The Marketplace Fairness Act of 2013 did pass the Senate but never passed the House before the end of the legislative term.

Over the next five years and subsequent congressional sessions, similar bills have been introduced with similar provisions. These bills, Marketplace Fairness Act (MFA) and Remote Transactions Parity Act (RTPA) were attempts to authorize states to impose a collection responsibility on remote sellers. The bills differed in how they defined sellers that would be required to collect the tax under differing small seller exceptions. None of these bills have been enacted into law.

In contrast to the bills that would authorize states to require remote sellers to collect tax, there were also bills proposed to codify the physical presence standard from *Quill Corp v. North Dakota*. Starting in 2016, the No Regulation Without Representation Act and the Online Sales Simplification Act were introduced. Taking the opposite approach of the Marketplace Fairness Act and Remote Transactions Parity Act, these proposed bills would have limited the ability of states to require remote sellers to collect use tax. The bill would define physical presence and create a de minimis threshold. If enacted, the bill would have preempted click-through nexus, affiliate nexus, reporting requirements and marketplace nexus legislation.

The Online Sales Simplification Act legislation would implement a "hybrid origin" approach for remote sales. Under the legislation, states could impose sales tax on remote sales if the origin state participates in a clearinghouse. In this case, the tax is based on the origin state's base and taxability rules. The rate would be the origin state rate, unless the destination state participates. In that case, the rate used would be a single state-wide rate determined by each participating destination state. A remote seller would only remit sales tax to its origin state for all remote sales. Only the origin state would be able to audit a seller for remote sales. Non-participating states would not be able to receive distributions from the clearinghouse. Sellers would be required to provide reporting for remotes sales into participating states to the clearinghouse, so it can distribute the tax to the destination state. Neither of these bills have passed.

After the *Wayfair* decision, a different approach was attempted in the federal Congress. On June 28, 2018, Sen. Jon Tester (D-MT) and additional members of the Senate introduced S. 3180, the Stop Taxing our Potential Act of 2018. The proposed legislation would prevent states from requiring businesses that do not have a physical presence in the state to collect and remit taxes. This bill failed to pass during the 115th Congressional Session running from January 3, 2017 to January 3, 2019.

On September 6, 2018, Rep. Bob Gibbs of Ohio introduced H.R. 6724, the Protecting Businesses from Burdensome Compliance Cost Act of 2018, in the U.S. House of Representatives. The objective of the proposed bill is "to limit the authority of a State to require remote sellers to collect taxes and fees owed by purchasers then located in such State incident to their purchases of goods and services from such sellers, and for other purposes." The bill provisions would only apply if the seller does not have physical presence in the state. The bill would require a single rate per state that cannot exceed the highest combined rate in the state. The proposed bill also contained prohibitions on requirements related to notice and reporting provisions other than aggregate tax data by zip code.

This bill failed to pass during the 115th Congressional Session running from January 3, 2017 to January 3, 2019.In an attempt to reverse the Supreme Court's Wayfair decision, on September 13, 2018, Rep. Jim Sensenbrenner (R-WI) and additional U.S. House members introduced the Online Sales Simplicity and Small Business Relief Act of 2018. Per the introduced legislation, a state would not be allowed to impose a sales tax collection duty

on remote sellers for any sale that occurred prior to June 21, 2018. A state would be allowed to impose a sales tax collection duty on remote sellers only for sales occurring after January 1, 2019. The legislation includes a small business remote seller exception.

For sales made by a "small business remote seller," states would not be allowed to impose a sales tax collection duty on any person other than the purchaser if the sale is made on or after June 21, 2018, and before the date that is 30 days after the date on which the states develop and Congress approves an interstate compact governing the imposition of tax collection duties on remote sellers. The legislation defines "small business remote seller" as "a remote seller with gross annual receipts in the United States during the preceding calendar year in an amount that is not more than $10,000,000." A person would not have physical presence in a state if the person's physical presence in the state was for less than 15 days in a taxable year (or a greater number of days if provided by state law), or if the person's physical presence in the state was solely for the purpose of conducting limited or transient business activity. This bill failed to pass during the 115th Congressional Session running from January 3, 2017 to January 3, 2019.

In the 116th Congressional Session, several pieces of federal legislation that previously failed to pass have been re-introduced. On January 9, 2019, Rep. Bob Gibbs of Ohio re-introduced the Protecting Businesses from Burdensome Compliance Cost Act of 2019 (H.R. 379), which would be effective January 1, 2020. On January 15, 2019, Sen. Jon Tester (D-MT) re-introduced the Stop Taxing Our Potential (STOP) Act of 2019 (S. 128) with a proposed effective date of August 1, 2019. On March 27, 2019, Rep. Jim Sensenbrenner re-introduced the Online Sales Simplicity and Small Business Relief Act of 2019 (H.R. 1933). Per the introduced legislation, a state would not be allowed to impose a sales tax collection duty on remote sellers for any sale that occurred prior to January 1, 2019.

As can be seen, just in the last five years there has been significant federal legislation proposed with no action.

As can be seen, just in the last five years there has been significant federal legislation proposed with no action. One of the arguments made in the Wayfair case was that the issue should be left to Congress to legislate and the Supreme Court should not interfere. This was the position of Chief Justice Roberts in his dissenting opinion in the case. The dissenting opinion agreed with the majority that physical presence is not required under the Commerce Clause but felt that Congress should address and resolve the issue.

That's the easy part. Now it gets more nebulous and difficult.

Monitoring Your Business for Nexus

The next step—and it's an on-going one—is to monitor your business for nexus. You need to constantly stay on top of the level of activity, visibility of the activities and your sales transactions. This is where many of the complexities and state-by-state idiosyncrasies raise their heads.

Physical Presence

Even with the *South Dakota v. Wayfair* decision, it is still imperative to monitor physical activities as if there is physical presence, the economic thresholds are not relevant. To monitor physical presence, you need to monitor the frequency and duration of your visits to a jurisdiction, and you need to be aware of each jurisdiction's rules. Certain activities might have safeguards to limit nexus. These not only vary by state but also by activity. For example:

- Are you participating in trade shows? Trade show rules differ by state. In California, it takes 16 days of trade show activity in a twelve-month period to create nexus. But in Texas, just one day suffices. And the type of activity you perform at a trade show could result in different results. If you bring inventory to the trade show and make sales and delivery, every state is going to require you to have a permit and collect tax – at least for the duration of the show. In Florida, as long as this is the only activity and it is for less than 3 days in a calendar year, you won't have continuing nexus after you leave. But if you exceed 3 days even just for a display booth, then you will be required to register and collect tax after you are gone.
- Do you have an employee actually residing and working in a state? In all states, that alone is enough to create nexus.
- Did you sign a contract in a state? That significantly raises the chance of nexus, even if it was your agent and not your employee who signed.
- Did you send anyone to perform installation, repair or training services? If so, you're creating nexus, whether it's your agent or employee providing the services. And this will create income tax nexus too!
- Did you ship products into a state via common carrier or company leased or owned truck? If it's a common carrier, you're probably okay. But if it's your owned or leased truck, you've likely created nexus.
- Do you pay commissions to a sales or referral agent? If it is related to click-through there might be a sales threshold that applies but this may not protect you with a traditional sales rep earning commissions.

Economic Nexus

If you don't have any physical activities, then you move to the economic nexus evaluation. When performing the economic nexus evaluation, there are four factors to take into consideration:

A. Threshold,
B. Includable sales,
C. Measurement date, and
D. When you need to register once you exceed the threshold

The threshold is the amount of sales and/or number of transactions that determine when you have substantial nexus in the state. The threshold may be a dollar amount only (e.g. $100,000) or a transaction count (e.g. 200 transactions). There is an increasing trend among states to not include or to remove the transaction count from the threshold and to only have a dollar amount.

When determining if you exceed the threshold in a state, you need to calculate your total sales into the state and count the number of transactions (when applicable).

Includable sales are the specific sales/transactions to include when determining if you meet the economic nexus threshold. States vary as to what sales are included to make up the threshold amount. Most will look at gross sales into the state, a handful are using retail sales (both taxable and exempt but excluding sales for resale) and just a few are using taxable sales. Sales made through a marketplace facilitator may be included or excluded when calculating the threshold for individual sellers, depending on the state, adding another important factor in determining an individual company's actual threshold status.

The measurement date is the time period for determining the amount of sales and/or number of transactions. The measurement date is most typically the current or previous calendar year. However, some states use a different measurement date. Other examples include: Previous calendar year only (Alabama); Preceding 12-month period evaluated quarterly (Illinois); The 12-month period ending on the last day of the most recently completed calendar quarter (Minnesota); and the immediately preceding four sales tax quarters (New York).

The on point that the states are consistent on is that any sales that occur before a seller reaches the threshold are safe from tax collection responsibility. But the states do vary on when a seller needs to register to collect and remit sales tax once they've exceeded the economic nexus threshold. This may be the next transaction, either per state guidance or the state doesn't specify. This may also be delayed. For example, Washington states that you must register on the first day of the month that starts at least 30 days after you meet the threshold. North Carolina states that you must register 60 days after you meet the threshold.

To find information on the threshold, includable sales, measurement date, and when you need to register once you exceed the threshold for each state that has enacted economic nexus legislation, visit our **Economic Nexus State Guide**.

Two additional factors should be taken into consideration when determining if you meet the economic nexus threshold. If you make sales exclusively through a marketplace and the state has enacted marketplace nexus legislation, you may or may not be required to register and file returns for sales tax. Additionally, states vary on whether a seller may cancel their sales tax registration if they drop below the threshold due to fewer sales or because marketplace nexus legislation has been enacted and the seller no longer meets the threshold. Both of these items vary by state and should be examined on a state-by-state basis.

States have greatly improved their ability to find remote sellers and identify presence in the state which creates nexus.

The visibility of your activities certainly has a role in gauging how easily a state might discover you, but not whether you have nexus or not. States have greatly improved their ability to find remote sellers and identify presence in the state which creates nexus. And states are finding new ways to target remote sellers. Several states such as California and Washington have contacted Amazon FBA (fulfillment by Amazon) sellers directly. And some of the states have filed subpoenas requesting lists of third-party sellers from marketplace providers. Amazon has complied with these demands after fighting the first few and losing.

For trade shows, if the show is open to the public you might have actually talked to an auditor telling them everything you can do for them. Plus, they actually visited your "place of business" trade show booth. If you advertise locally, including providing in-state contact information in phone and industry directories, you have a placed a sales tax target on your back. And if you are selling to any state or local agencies, your nexus is now well-known as most states cross reference their suppliers against the registered taxpayer database. In fact, some states prohibit the government agencies from contracting with a supplier that isn't registered to collect sales and use tax in their state. It is important to alert your sales team that if any government contract or trade show registration packet includes a sales tax registration form that they send it to the finance or tax group for completion.

Economic Impact of Nexus.

We've talked about what nexus is and how you get it, but you can have all the nexus in the world and have no issue or a giant one. This is what we call the economic impact of your activities. Understanding what the dollar value of your average sale into a jurisdiction is, when your sales and other activities commence, and what the total amount of sales into a jurisdiction since activities began all help to determine a potential liability. This has become even more important to understand with economic nexus. In states that use a gross sales threshold, sellers that exceed the threshold are deemed to have nexus. But, is there a requirement to register and collect tax? Maybe not. But the establishment of nexus means the company is subject to the laws of the state.

You can have all the nexus in the world and have no issue or a giant one.

One important way to estimate the actual economic impact of nexus is to determine what percentage of sales are taxable in a given state. Some sales will qualify for an exemption based on the nature of the good or service sold, while other sales may be exempted based on the use an item or service is put to or may be exempted based on the nature of the purchaser. But it's

up to the seller to know which are exempt and which are not, and to obtain proper exemption certificates for exempt sales (don't count on being able to get them after the fact, because that isn't always allowed or realistic). How your invoices are written is important too. In some states, a normally exempt item becomes taxable if it is not itemized as a separate item on an invoice. Proper resale certificates are equally important. If they are not on file, an auditor will likely determine an error rate and project the missing certificates across the audit period to assess tax, interest and penalties.

So, if all your sales are exempt, you might not have much to worry about in terms of a liability. Whether you choose to register or take the chance of discovery by the state is dependent on your risk tolerance and the facts of your situation. Always keep in mind one advantage of registering and filing, even if no tax is due: the statute of limitations begins to run on any period where a return is filed. The statute of limitations protects taxpayers from examination of periods outside the statute lookback period. Not being registered leaves the prior periods open indefinitely in most states since no returns are filed.

III. DEALING WITH NEXUS ISSUES

Now that you've gathered all the facts about your activities, what do you do when you discover you have created nexus? If you have just established nexus, it's simple: register with the jurisdiction(s) immediately and begin collecting sales tax. But if nexus was created sometime in the past and you haven't registered, then you have a decision to make. Most of the states have been reasonable in dealing with sellers who have struggled to identify where they have economic nexus and coming into compliance. However, as the effective dates become further in the past, this is expected to diminish. Ignoring nexus is no longer an option. Fortunately, there are options to consider that may decrease the negative impact:

- **A Voluntary disclosure agreement** (VDA) is a very good proactive option, provided it's open to you. One universal requirement for qualification for a VDA requires the taxpayer has never been contacted by the state regarding in-state activities, unless in the rare case where a state has determined a taxpayer has no collection obligation in writing. In states with voluntary disclosure programs, the usual course is to apply anonymously to the state, under the aegis of a third party, describing your activities and their duration within the state. However, some states require identification of the taxpayer at the outset or require it before a VDA is approved. If a taxpayer qualifies, an agreement can often then be reached with the revenue authority that leads to a limitation of open years and an abatement of penalties. The Multi-State Tax Commission runs a national program enabling businesses to enter into voluntary disclosure agreements with multiple states at one time. Whether to pursue voluntary disclosures directly with the state versus through the Multistate Tax Commission requires an analysis of the pros and cons of each. An experienced state and local tax consultant can help you determine the right path for your business.
- **Amnesty** for uncollected or unpaid sales taxes is also available periodically as states implement amnesty programs. For states participating as members of the Streamlined Sales and Use Tax Agreement, amnesty is available for all associate member states which currently only includes Tennessee. Other individual states sometimes offer amnesty programs as well. State amnesty programs vary in their look-back periods and they might be restricted to certain taxes or types of businesses. You can find a list of amnesty programs – current, future and past which includes details on the program on our **Amnesty Chart**.
- Don't register but **monitor your activities and potential liability**. In states where nexus has not been created, or the liability is small or the activity is minimal, you may choose to take the wait and see approach. But, keep any eye on what is happening not only with your business activities but also with state law to know when you need to take action. Remember that any tax not collected could be assessed against the seller if nexus had existed at the time of the sale.

Regardless of the approach you take, it is a sound strategy to reach out to your customers and determine if they have either paid the use tax directly to the jurisdiction or if they qualify for an exemption. If they can certify that the tax has been paid or provide you with a valid exemption certificate, these amounts can usually be deducted from your liability for prior periods. However, relying on your customer to pay the tax going forward is not an option. If you have nexus, you have the obligation to collect the tax. It is also a good idea to require exemption certificates from all customers claiming an exemption, even in states where the seller might not be registered. For states that use a retail or taxable sales threshold test, if the certificates aren't on file, these sales are considered taxable sales and will count in determining the threshold.

> **Now that the economic nexus "window" has been opened, states are aggressively attempting to expand this to other taxes particularly income tax.**

We've focused on sales and use tax nexus. However, don't forget about other taxes and compliance requirements including entity income tax, individual income tax on employees and owners for flow through entities, business license requirements, property tax, unclaimed property, and other specialty taxes and fees. Now that the economic nexus "window" has been opened, states are aggressively attempting to expand this to other taxes particularly income tax. Efforts are underway to repeal the federal protections of P.L. 86-272. Some states have recently enacted economic nexus provisions for corporate income tax in clear violation of federal law. A task force of the Multistate Tax Commission has been working on the repeal of the federal laws.

Be careful about when you start collecting

One thing you do not want to do is start collecting sales taxes prior to being registered with a jurisdiction—it's flat-out illegal and penalties can apply. In fact, in most states, this is considered criminal fraud. However, some states might let you start collecting the tax once you've filed for a voluntary disclosure even if your registration process is not yet complete. In these cases, you need to remit what you've collected immediately upon the completion of the registration. Also, be sure to request this in the application and put the state on notice if there is any tax collected. If you don't, this could be considered a material misstatement that could invalidate any voluntary disclosure agreement.

Nexus? Not!

Occasionally you may find yourself in the situation that you are registered with a jurisdiction, but there is no nexus. In these cases, you can contact the jurisdiction and cancel the registration. But it is not a slam-dunk. You can expect to be scrutinized, so make sure you're correct in your evaluation.

Many of the states that have enacted economic nexus have included provisions whereby a seller evaluates nexus on an annual basis, looking at whether they have exceeded the economic threshold in the prior year. If not, then they could cease collection and close their registration. Given the challenges with opening and closing registrations, some of the states have talked about implementing an "inactive" status. For physical nexus, states typically look at the prior 12 months to determine if there is continuing nexus. Again, closing and re-opening registrations is challenging and confusing to customers so many sellers don't do this even if they could.

In these situations, you may be able to elect to continue to collect and remit taxes as a "voluntary filer" if you think there will be some business despite your lack of presence in the jurisdiction. If the state recognizes the voluntary filer status, there may be a reduced administrative burden such as less frequent filing frequency or simplified rates to apply. This doesn't apply often so don't expect it.

IV. MINIMIZING THE IMPACT OF NEXUS

If there is one takeaway we hope you have learned, it is that dealing with sales tax nexus, its implications, and the ever-shifting landscape of sales tax requirements is a complex and time-consuming process. It can also be very expensive, in terms of internal resources as well as penalties and interest if you don't get it right. According to a 2011 Aberdeen Group Research Brief on Sales & Use Tax Compliance Costs, the average annual cost of sales tax compliance wages ranges from $21,896 for small enterprises to $42,106 for midsize enterprises and to $49,627 for large enterprises. These costs include filing and remittance of sales tax, managing exemption certificates and calculation of sales tax. These costs do not include any software, hardware or outside resources. Additional costs are incurred if an audit occurs during the year.

Clearly, for small to mid-sized companies, trying to manage sales tax compliance using only in-house resources and relying on manual processes can be risky. If you're a fast-growing company, the risk just compounds each time you enter a new taxing jurisdiction, launch a new product or services, add a new line-of-business, acquire a new company, etc. Thus, it's highly advantageous to seek outside help, both to raise your sales tax compliance expertise and to bring down your costs of compliance.

We recommend the following course of action:

- **Be proactive.** Don't wait until you receive a nexus questionnaire—leverage outside professional sales tax services and counsel to help you conduct a thorough nexus study of your activities upfront and continue leveraging these expert resources as you grow to help manage your nexus exposure. In the long run, it's substantially less expensive than trying to hire, train and maintain in-house expertise. We offer a Wayfair Risk Analysis service for remote sellers who either only have economic nexus or limited nexus such as through the presence of inventory in a third party warehouse. For more information and to schedule your analysis, visit our **Wayfair Risk Analysis page**. If you have broader nexus presence through various physical activities, we can assist through the performance of a **nexus study**.
- **Automate.** Manual processes for managing sales tax are time-consuming, resource-intensive and error-prone. Automation streamlines the process and eliminates the errors. Where this was once only an option for larger enterprises, new on-demand and managed services now enable small to mid-sized companies to enjoy the benefits of automation, coupled with a range of essential services including expert tax research, automated preparation of monthly audit data and signature-ready returns, and on-demand professional help in managing audits should they arise. You can learn more about tax automation with the following free downloads: **Best Practices in Transaction Tax Systems Implementation** and **No Excuses: Automation Advances Make Sales Tax Collection Easier for Everyone**. For some option see our list of **Tax Software providers**.

The one thing you don't want to do is trust that you can continually cover all the bases of nexus by yourself. Nexus is stealthy—it creeps up on you, leaving you sitting on a hidden penalty and interest time bomb. Nexus is multi-faceted—there are so many ways to fall into it, state by state. Nexus is dynamic—the rules change continuously. Nexus is necessary—at least to taxing jurisdictions, which are increasingly creative and aggressive in their enforcement.

Dealing with sales tax nexus, its implications, and the ever-shifting landscape of sales tax requirements is a complex and time-consuming process.

To learn more about understanding your nexus liabilities or managing the associated compliance obligations we encourage you to **contact us**.

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The Sales Tax Institute offers live, webinar, and online courses to educate business professionals about sales and use tax. Sales Tax Institute's resources, tools, and courses are built to help you understand critical concepts and applications in sales tax today. You learn how to apply theory into your day-to-day practice so that your work becomes better, faster, and more accurate.

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About YETTER Tax

YETTER is a sales and use tax consulting firm that offers clients the highest quality sales and use tax guidance by understanding their needs, increasing awareness of current tax issues and trends, and providing effective tax-related solutions

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