Navigating the Post-Wayfair World Part Three: Practical Advice & Tangible Next Steps

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Practice Area: Business and Corporate Law & Tax

This *Legal Update* marks Part Three, and our final installment of the three-part series, Navigating the Post-*Wayfair* world. In Part One, we discussed how states have responded to the Supreme Court's landmark sales and use tax decision, *South Dakota v. Wayfair, Inc.* In Part Two, we illustrated how Wisconsin has responded to the Court's decision. In Part Three, we offer practical advice for businesses navigating the post-*Wayfair* world.

All businesses should be assessing how the Court's decision impacts operations. Generally, remote sellers can be any business that sells goods or services from one state to another. Though much of the focus post-*Wayfair* has been on the sale of tangible personal property (*i.e.*, goods), many states also assess sales tax on various services—including telecommunication, management and utility services. Some states have even begun to tax digital goods as well.

Furthermore, even though the *Wayfair* case dealt with large retailers, smaller and middle-market retailers are impacted as well. Even businesses that are not resellers, likely do business with vendors and suppliers who are adjusting their operations in light of the decision. In this *Legal Update*, we will offer step by step guidance for conducting an economic nexus analysis. We will also discuss changes that should be anticipated regardless of your businesses location on the supply chain. Let there be no doubt, *Wayfair* has changed the landscape for *everyone*.

Be Proactive
As we wrote in Part One, over 30 states enacted economic nexus laws since mid-2018, most of which have already taken effect. The narrow compliance period in a post *Wayfair* business environment has created urgency for affected businesses. Thus, businesses not currently collecting and remitting sales tax in states where economic nexus exists may face increased compliance issues and a possible growing deferred liability.

The risks of non-compliance run high. Non-compliant businesses can be liable for directly paying amounts owed out of pocket (rather than from the customer). Non-compliant businesses can also be hit with hefty penalties and fees. Moreover, many states impose personal liability on those operating the business (*i.e.*, officers, directors, partners, managers, or other "responsible persons"), with automatic veil-piercing statues, for the failure to collect and remit applicable taxes.

We know now that in this post-*Wayfair* world, companies doing business in multiple states will almost certainly have expanded sales tax obligations. Rather than waiting to receive a nexus questionnaire in the mail from one of the many states passing legislation, businesses need to accept that the cost of doing business will likely increase and begin to take proactive action.

Proactivity begins with having the proper resources in place. Assess whether current processes—software, staffing, external resources—are sufficient to navigate the post-*Wayfair* world.

Post-*Wayfair* Resource Checklist

- **Accounting Software.** Reliable, detailed accounting/bookkeeping software that can effectively sort sales by jurisdiction (zip code and state).
- **Point of Sale Software.** POS software that can apply the correct taxability determinations (including varying sourcing rules) and accurately calculate sales tax.
- **Sales Tax Software.** Sales tax software can automate much of the collection and remittance process. Understand that implementation takes time, and can be expensive.
- **Staffing/External Resources.** Nexus analysis is heavily dependent on the specific language of state laws. This is complex, and requires careful attention to detail. Consider whether your current staffing arrangements have the capacity to take on this analysis, and outsource this work to an outside tax advisor if necessary.

Be Strategic
All businesses that conduct business out of state will need to conduct a nexus analysis to determine where they have obligations. Though this analysis will vary for every business, we have identified 6 key steps.

Step One: Review sales history by state.
To begin, use your accounting software to review your sales history in every state. In each state that collects sales tax, identify the number of sales made annually into that state and the number of transactions conducted annually in the state. Create a chart like the one below that shows each state that collects sales tax, along with the number of sales in the previous year, the number of sales in the current year, the total dollar value of the sales in the previous year and the total dollar value of the sales in the current year.

A bit of good news: five states (New Hampshire, Oregon, Montana, Alaska and Delaware) do not collect sales tax.

Example No. 1 – State-by-State Sales History

	Number of Sales Previous Year* [2018]	**Number of Sales** Current Year* [2019]	**Total Dollar Value** Previous Year* [2018]	**Total Dollar Value** Current Year* [2019]
State #1	70	45	$500,000	$300,000
State #2	250	95	$830,000	$300,500

The appropriate benchmarks for "previous year" and "current year" will vary from state to state depending on how that state defines "year." Some states define "year" as a business's *taxable* year, others define it as a *calendar* year, and some define it as the prior 12 months. The examples provided here contemplate a calendar year.

Step Two: Conduct a state-by-state nexus analysis.
Next, review the economic nexus standards in each state where your business has sales activity. Compare the sales and transaction thresholds set forth by the state economic nexus standard to your sales activity and determine whether you have nexus in that state. Remember, states have not followed a uniform approach in adopting economic nexus laws, and variations exist from state to state. When reviewing state laws, keep in mind the following pointers:

- **Physical Presence.** Nexus can still be established by physical presence, and the traditional physical presence rules still apply. For example, owning or leasing property in a state, conducting in-person activities in a state, and providing in-person services in a state (among many other activities) still creates nexus.
- **Variations.** In Part One, we discussed a number of key variations between state economic nexus standards. Keep an eye out for these variations and remember that slight variations in wording and definitions (even a single word) can make a significant difference.
- **Update Sales History.** Certain nuances in state law may require refining the sales history data that was collected during step one. For example, Wisconsin defines "year" as a business's taxable year. As we noted above, the examples provided here contemplate a calendar year. So, our sales history data for Wisconsin would need to be updated to reflect the businesses previous taxable year (2017) and current taxable year (2018), rather than the previous (2018) and current calendar (2019) years.
- **"No-Nexus Determination."** If applicable, make a "No-Nexus" Determination. Sometimes being proactive means having your legal position well determined and filing no returns. For example, if you fit into one of the exemptions for a particular state's nexus requirement, that documentation can be retained for future contact.

Step Three: Identify potential tax liability in each state.
Once you determine where you have nexus, identify the potential tax liability in each of these states. Assess the dollar value of taxable sales made into the state, multiply by the applicable tax rates and add any penalties and interest for your total exposure in the state. Again, the applicable rates and values will vary state to state. Sales tax software can automate much of this analysis.

Example No. 2 – Potential Liability

State	Year	Total Dollar Value	Taxable Sales	Tax Due at 5%	Penalties and Interest 100%	Total Exposure
State #1	Previous Year	$500,000	$450,000	$22,500	$22,500	$45,000
	Current Year	$300,000	$200,000	$10,000	$10,000	$20,000

Step Four: Consider risk mitigation tactics.
Risk mitigation tactics may help businesses reduce their liability in certain circumstances. Some states offer voluntary disclosure agreements (VDA's), which can ease compliance burdens for non-compliant participants by limiting the lookback periods, reducing fines and penalties and establishing payment plans. Contact your tax advisor to determine if this is an appropriate option for your business.

Step Five: Develop a compliance schedule.
Compliance will not happen overnight. Remote sellers should develop a compliance schedule that fits the specific needs of their business. Calendar the dates you will register with the state, begin collecting sales tax from your customers in that state, and remit the collected tax back to the state. Prioritize compliance in the states (1) where you have the largest potential liability, and (2) have the longest lookback periods.

Some companies may find the Streamlined Sales Tax Registration System (SSTRS) software helpful. A word of caution however—registering through the SSTRS software automatically registers your business in all 24 member states; possibly subjecting you to sales tax obligations that you are not actually responsible for.

We anticipate that states will argue that remote sellers must collect and remit as of the day the state's economic nexus laws became effective, if their historical sales activity exceeded the applicable thresholds. If that's the case, liability begins to accrue on the day the state law became effective.

Be sure to keep detailed records of all compliance efforts (or "no-nexus" determinations) —these records may be helpful in the event of an audit.

Step Six: Implement monitoring programs.
As the sales and use tax landscape continues to evolve, so should your monitoring programs. An effective monitoring program should track external and internal changes. Externally, you should have a system for monitoring state law, including sales and transaction thresholds, taxability, tax rates and filing requirements. These standards will undoubtedly continue to evolve as issues are played out in court. Internally, an effective monitoring program should automatically signal when sales or activities exceed thresholds in each state and thus trigger sales tax obligations. They should also monitor payment and filing requirements.

Be Prepared

- **Audits/Enforcement Activity.** Given the flurry of activity at the state level in the first six months post-*Wayfair*, we anticipate that in the next six months we will see a growing increase in enforcement activity. Businesses should review their record-keeping and documentation practices now to ensure that the documentation required to support potential future audits (*e.g.*, exemption certificates, resale certificates, invoices, etc.) is readily available.
- **Exit Planning.** Sales and use tax compliance is routinely assessed during due diligence, and is oftentimes the largest state tax exposure item. These discoveries can lead to an adjustment in valuations and indemnification clauses. Again, having the appropriate documentation readily accessible will save time and costs down the road.
- **Beyond State Sales Tax.** We anticipate localities may embrace economic nexus rules as well. With over 10,000 taxing jurisdictions in the United States, it is easy to see the critical role accounting and sales tax software will take post-*Wayfair*. In addition, we anticipate the *Wayfair* decision will eventually lead to changes in income and franchise tax rules.
- **Other Business Implications.** All contracts for the sales of goods should be reviewed to ensure that sales tax is properly contemplated. Businesses should also review their invoices to determine if they properly display tax calculations and whether they bundle taxable and exempt products. Finally, be prepared for changes in your vendor and supply contracts.

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