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The biggest US states are getting serious about Wayfair

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For all companies that sell to US consumers without a physical presence in states, 2018's Wayfair decision was a bolt from the blue. But the work of complying with 'economic nexus' rules in every taxing jurisdiction will be an ongoing project, not a one-off effort.

When the Times Square ball dropped to usher in the new year, most of the largest states in the US were still yet to pass laws to introduce new 'economic nexus' requirements for out-of-state vendors following the Supreme Court's decision in *South Dakota v. Wayfair Inc (Wayfair)*.

That will change in 2019, with California, Florida, New York and Texas – which account for a third of the US population – poised to make their moves.

"The states have known about these issues for years," says John Buhl of the Tax Foundation. "Everyone's been aware of it. I'd be surprised if there wasn't at least an idea by the end of each legislative session this year of what a state is going to do or when they're going to do it."

The bad news is that the states that are yet to introduce post-*Wayfair* economic nexus rules are the ones whose sales tax codes will present far greater compliance challenges for businesses that find themselves having nexus there for the first time.

Software and mapping

Most of the states that have already followed South Dakota in introducing economic nexus laws are party to the Streamlined Sales and Use Tax Agreement (SSUTA), an agreement that aims to simplify and consolidate state tax codes.

Yet the largest states, have not joined the SSUTA, largely because of political considerations: simplifying complex patchworks of

rates and exemptions would cause some voters and businesses to lose out.

'Streamlined' states, as part of the agreement, provide a one-stop online portal to allow businesses to calculate sales tax rates across the state and file a single return. But states that are not party to the SSUTA will not necessarily provide their own software platforms.

One result of *Wayfair*, then, will be to send many firms to private software providers. "If you are not a member of Streamlined", explains Richard Pomp, professor of law at the University of Connecticut School of Law. "Then you are left buying software in the private sector. The real problem with buying software is integrating it with your existing accounts-payable-accounts-receivable system. That is not easy."

Yet the challenge of building a consolidated back-room system will pale in comparison to the burden of constantly keeping track of differential rates for different categories of products. And there are limits to how far software providers can help businesses in categorising products for tax purposes in a machine-readable way, which is known as 'mapping'.

Pomp explains: "Suppose food is not taxable by such-and-such a state. You now have to code the products you sell into the software and tell the software that this product is food. Well, it's not obvious always what food is." A human has to make a decision about that. "The software is not a panacea by any means," he adds.

The complexities multiply when localities within a state are able to set their own taxability rules. "Even within a state, from local jurisdiction to local jurisdiction, you could have differences in taxability, à la Colorado and [other 'home-rule' states]", says Nancy Manzano, director at the chief tax office of tax technology company Vertex.

Home-rule headaches

The new burdens of a post-*Wayfair* world will not just relate to calculating tax rates, but also to filing returns.

So far, the states that have introduced economic nexus provisions have been ones in which taxpayers can file a single consolidated return for all sales tax payable in the state.

That is unlikely to be possible in the so-called 'home rule' states such as Alabama, Colorado, Idaho, and Louisiana.

In home-rule states, local authorities do not simply set their own rates and taxability requirements but are also responsible for collecting and administering the taxes themselves.

This means that if a company has nexus in a home-rule state, it must file not just one return, but a separate return for every locality it sells into.

The complex interrelation between state and local governments in these states is precisely the reason why they have held off introducing economic nexus rules, says Buhl.

"Initially [Colorado's] department of revenue was thinking: 'All right, we're going to get this started, just like some of these other

states', and then they pulled back, because they realised that they could maybe force you to do the state part of it but not the local part."

"They're trying to negotiate how all of this might even work right now."

Colorado has 307 taxing jurisdictions. Louisiana has 341. And given that companies often have to file returns quarterly, the number of returns that firms will have to file could skyrocket in many cases.

Unsurprisingly, as Manzano says, "the compliance aspect can be burdensome – the actual filing of the returns, that really can be an armful."

"And when you think about it, some of the sellers that are being captures by these post-*Wayfair* rules and legislation are of a size that they may not have any in-house tax people."

Joe Endres, a partner at Hodgson Russ in New York, is more direct. He says home-rule states will be "a huge pain".

Possible future disputes

So burdensome could the new filing requirements be that some experts think that, if states like Louisiana and Colorado do not provide a simpler, consolidated way to file returns, their economic nexus rules could be open to legal challenge.

"Here's where I think the likely litigation is," says Pomp. "Suppose I'm a remote vendor, I'm selling into a state, and the local jurisdictions in that state have sales taxes that deviate from the state sales tax.

"I make a handful of sales into one local jurisdiction. But because I have nexus with the state as a whole, the thinking is I have nexus with any subdivision of the state. Which means I am now going to have to collect sales tax in a jurisdiction that I might be selling \$1,000 of goods into.

"And I am being asked to administer and deal with that local municipality's rules. And it may cost me ten times more in my compliance cost than the profit that I make off that \$1000."

He referred to an obscure constitutional principle that some legal thinkers believe can be used to strike down unduly burdensome tax compliance requirements.

Others agree. "I think that is legally open", Endres says about a situation parallel to the one Pomp describes.

Richard Auxier, a research associate at the Tax Policy Centre, also anticipated this aspect of the nexus rules would come in for legal challenge. "America loves court challenges," he says, "so I'm sure someone will sue."

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