State Tax Implications of *Wayfair* for Non-US Companies with US Customers

Overview

On June 21, 2018, in *Wayfair et. al.*[1] the U.S. Supreme Court overturned the sales/use tax nexus standard of physical presence established in *National Bellas Hess* (1967)[2] and later upheld in *Quill* (1992).[3] Non-US companies who make sales of goods or taxable services to US customers have historically not been subject to a state or local sales tax collection responsibility on such sales unless they had a physical presence in the state of the customer, either directly or through an agent. With the Supreme Court's decision in *Wayfair*, inbound non-US companies and/or their US subsidiaries are now faced with potential collection and filing responsibilities in states with laws similar to those of South Dakota as well as those states with provisions extending nexus to "the extent permissible under the U.S. Constitution." As is discussed below, the concepts of Permanent Establishment (PE) and treaties generally provide no safe harbor relative to the determination of nexus for state (or local) sales and use tax purposes.

For further information on *Wayfair* decision and the potential implications for remote sellers overall, please see our June 26 tax alert available here.

Considerations for foreign companies with US sales

The South Dakota statute upheld in *Wayfair* imposed a sales tax collection responsibility on sellers if annually their sales to South Dakota customers exceeded $100,000 or if the seller had 200 or more transactions with South Dakota customers.[4] As a general rule, the levy of sales/use tax under the South Dakota statute is determined based on the location of the purchaser, without regard to where the sale originated. For example, a tangible good shipped directly from Asia to a customer in the US could be taxable if the seller meets the in-state sales/transaction requirements. Therefore, to the extent a seller, domestic or *foreign*, has sufficient sales/transactions in a state with a similar rule to the one upheld in South Dakota, the remote seller would now have a collection obligation. It is important to note that states are generally not bound by tax treaties, and bilateral tax treaties generally do not otherwise apply to non-income taxes at the state level.

Recommended analysis

Consider what state(s) may potentially levy sales and use tax on the transaction. As noted above, a sale is typically subject to sales/use tax in the state of the purchaser. However, it can be complicated to determine where to source a particular sale, especially where the purchaser is a large organization with many locations. For example, the sale of a software license that is used by an organization with office locations spread across multiple tax jurisdictions may result in sales tax potentially spread among those jurisdictions. Certain states have already enacted remote seller statutes similar to the one at issue in *Wayfair*, while others have not. Accordingly, it is crucial for companies to analyze their US sales activities and the potential states at issue.

Consider whether the products and/or services being sold are in fact subject to sales/use tax. Unlike many value added taxes, the vast majority of states primarily limit their imposition of sales tax to the sale of tangible property - i.e., many services are not subject to sales and use tax. However, this is not universally the case, as there are an increasing number of states that tax a growing list of different kinds of business services, notably those involving data processing, software and online or other cloud-based information technology (IT) services. For example, certain states do

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[1] *South Dakota v. Wayfair, Inc., et al.,* No. 17-494 (June 21, 2018) 585 U.S. ___. A copy of the decision is available here.
[2] *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967).
[3] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).
[4] The obligation applies to sales of tangible personal property, any product transferred electronically, or services delivered into South Dakota.

not tax software except where it is delivered in tangible form, while others tax electronically downloaded software and "software as a service" subscriptions.

Consider available exemptions. There are also a number of different types of exemptions that may apply, depending on a particular state's rules. These typically include:

- Sales of goods or services for use in manufacturing or industrial processing;
- Sales made for re-sale;
- Sales to non-profit, government or other tax exempt entities.

As determinations can be highly fact specific, companies are encouraged to consult with their tax advisors with respect to each of their particular products or offerings as well as the nature of their customer base. In addition, companies may now have an obligation to register for sales tax collection though the necessary basis for an exemption exists. States typically require certain documentation to be maintained by the seller, such as properly completed resale exemption certificates, in order to validate qualification for an exemption.

Compliance, potential retroactivity, and exposure considerations

As states generally do not recognize branches in the context of sales/use taxes, the legal entity making the sale and with nexus in the state has the sales/use tax collection responsibility and must register with a state and file periodic sales/use tax returns. Companies will need to have systems in place to be able to accurately compute and collect sales tax at the time of the customer sale.

Sales/transaction-based nexus statutes or administrative rules have been in effect since at least 2016 in a number of states, and the issue of retroactive enforcement must be closely analyzed in such states. In addition to sales/transaction-based sales and use tax nexus statutes, approximately ten states have enacted sales tax notification and/or reporting statutes in the last several years. Such states require remote sellers to provide in-state buyers with information regarding their use tax obligations, as well as provide a report to the state detailing in-state purchases. Failure to comply in some instances may result in the levy of per transaction penalties, which may exceed the underlying sales/use tax. Accordingly, prior to registration in a state, foreign companies should analyze whether there are any exposures for prior sales to customers (or for failure to provide the required information to buyers/state revenue agency) and whether negotiation of a pre-registration agreement with a certain state (e.g., through a Voluntary Disclosure Agreement) is advisable.

Other state tax considerations

It should also be noted that the Court's holding in *Wayfair* may potentially impact the state-level nexus determinations relative to income, gross receipts, telecom, utility and/or franchise taxes (the latter based on net worth or capital). Relative to the state levy of net income taxes, while many states ultimately conform to the benefits of permanent establishment clauses present in US bilateral tax treaties, certain states do not limit the income tax base to effectively connected income (and may not extend the safe harbors provided by Public Law 86-272[5] to foreign taxpayers).

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[5] Public Law 86-272 is a federal law enacted in 1959 which prohibits states from levying a net income tax upon an out of state company if the company's activities in a state are limited to the solicitation of orders for the sale of tangible personal property and the orders are approved and filled from outside the state.

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If you have any questions regarding the sales and use tax implications of this important decision upon non-US companies or their US affiliates, please contact any of the following Deloitte Tax LLP professionals:

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