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After Wayfair, What Now?

July 13, 2018

Client Advisory
July 13, 2018 by Raphael S. Grunfeld

In our firm's previous Client Advisory of June 26, 2018, we reported on the US Supreme Court five against four decision in South Dakota v. Wayfair which upheld a South Dakota law that could require an out-of-state seller with no physical presence in South Dakota to nonetheless collect sales tax and remit it to the South Dakota taxing authorities if the seller, on an annual basis, delivers more than $100,000 of goods or services into South Dakota or engages in 200 or more separate transactions for the delivery of goods or services into the state.

As a result of the Wayfair decision, an out-of-state seller with sufficient sales or transactions in states with laws similar to South Dakota, may soon have to register in those states and collect sales taxes there. Considering that there are more than 10,000 taxing jurisdictions in the United States, each with their own rates applying to various products or services with different substantial presence standards, this could be quite an onerous compliance burden.

It is possible that Congress might step in and enact legislation to provide a uniform sales tax standard, but that has not happened yet.

In the meantime, many states, relying on the US Supreme Court's suggestion that the South Dakota law is not unconstitutional, are already drafting their own sales tax laws mimicking South Dakota's. Other states, whose own versions of economic nexus sales tax laws were frozen when the Supreme Court first upheld the physical presence test many decades ago, are getting ready to revive them. Presumably, the less a state's sales tax law deviates from South Dakota's sales tax law which the US Supreme Court addressed in the Wayfair decision, the more likely it is that the law will be upheld. Although it would be pushing the envelope, there is no guaranty that some states, particularly those with no income tax laws, will not apply sales tax on internet sales retroactively. The Hawaii Department of Taxation has announced that it will enforce its law retroactively and require online retailers to pay tax on sales going back to January 1, 2018.

So what should internet companies selling into US states do now?

- They should conduct a review of their present and future contemplated activities and sales levels in states in which they do not have a physical presence.

- If they are selling business services, particularly services involving data processing, software and online or other cloud-based IT services, they should check whether the states they sell into levy sales tax on those services or impose sales tax filing requirements.

- Before registering for sales tax in a state, they should evaluate any potential prior exposure arising out of past sales into that state. They should then consult with their advisers to consider approaching the states under any voluntary disclosure or amnesty programs, while they are still available, rather than rushing to register and then getting audited for prior periods. Such amnesty programs typically waive interest and penalties if the taxpayer meets the amnesty requirements.

- Because South Dakota is the tip of the iceberg, they should begin to plan for IT systems that can handle an increase in state tax collection and compliance across the US.

After Wayfair, non-US companies selling goods or taxable services to US customers face potential collection and filing obligations too. However, in the absence of a treaty between any foreign country and the US regarding the collection of sales tax, it is not clear how a state judgment against a non-US seller could be enforced.

It is important to note that the Wayfair decision addressed the question of what constitutes doing business in a state for purposes of collecting sales tax. It did not address what constitutes doing business in a state for the purpose of being required to qualify to do business in that state. In general, qualifying to do business in another state entails obtaining a certificate of authority from the Secretary of State of that state, maintaining a registered office there and filing annual reports with the Secretary of State. Whether an internet seller, with no physical presence in the purchaser's state, needs to qualify to do business there is a question to be answered by the corporate law of each specific state it sells into and the degree of contact it has with that state in any given situation.

It is unclear, at this time, how Wayfair may impact state income taxes.

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