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Polling Question #1

Are you interested in learning more about the new Thomson Reuters Checkpoint Edge solution?

- Yes
- Not interested right now
Agenda – Where Are We Now

► Federal Restrictions on State Taxing Power
► *Wayfair* and Why it Does (or Doesn’t?) Matter
► The Commerce Clause – Nexus Issues After *Wayfair*?
► Due Process Clause Nexus – Meaningful Protection or Obsolete Inquiry?
► Marketplace Facilitator Laws & Litigation
► Public Law 86-272
► A Global Comparison

Frequently Encountered Federal Restrictions on State Assertions of Tax Presence

► Limitations Imposed by the U.S. Constitution:
  ◆ Commerce Clause
    ▶ Sales & Use Taxes
    ▶ Income Taxes
  ◆ Due Process Clause
    ▶ Sales & Use Taxes
    ▶ Income Taxes
    ▶ Taxation of Trusts
► Congressional limitations:
  ◆ Public Law 86-272
    ▶ Income Taxes Only
  ◆ Internet Tax Freedom Act
    ▶ All “Taxes” within the Law’s Definition
**Wayfair and Why it Does (or Doesn’t?) Matter**

In *South Dakota v. Wayfair*, the U.S. Supreme Court struck down *Quill’s* physical presence rule. The Court held that South Dakota’s $100K/200 transaction threshold was evidence of a “substantial nexus” between the state and Wayfair. The Court also noted that South Dakota’s law likely did not impose an undue burden on interstate commerce because, among other reasons, it explicitly prohibited retroactive application. What open questions, if any, remain with respect to nexus and sales/use taxes?

- The case involved only South Dakota’s sales and use tax.
- How does *Wayfair* impact the constitutionality of income taxes?
- *Wayfair only* implicated the Commerce Clause.
- How does *Wayfair* impact other constitutional and congressional limitations on state taxing power?

**Summary of Wayfair**

- In *South Dakota v. Wayfair*, the U.S. Supreme Court struck down *Quill’s* physical presence rule.
- The Court held that South Dakota’s $100K/200 transaction threshold was evidence of a “substantial nexus” between the state and Wayfair.
- The Court also noted that South Dakota’s law likely did not impose an undue burden on interstate commerce because, among other reasons, it explicitly prohibited retroactive application.
- What open questions, if any, remain with respect to nexus and sales/use taxes?
- The case involved only South Dakota’s sales and use tax.
- How does *Wayfair* impact the constitutionality of income taxes?
- *Wayfair only* implicated the Commerce Clause.
- How does *Wayfair* impact other constitutional and congressional limitations on state taxing power?
Understanding the Tests

► Taxpayers in *Wayfair* were huge vendors, in no way positioned to challenge whether the nexus thresholds (more than $100,000 in sales or at least 200 transactions) are (a) set too low or (b) coherent when paired.

► Consider: The pairing implies an average sale of $500 ($100k/200). How often have you spent $500 on a purchase over the Internet? What is the average dollar amount of your Internet purchases?

If an average Internet purchase is $100, then the real threshold is not $100,000 – it is $20,000 ($100 x 200 transactions). If a state’s sales/use tax is 6%, this yields $1,200 in taxes.

► What are the out-of-pocket and other costs involved in complying with 10, 20, or more remote jurisdictions’ laws?

► The states object to the inefficiency of collecting use taxes from their residents.

► Is it equitable to impose inefficient collection costs on remote small businesses to relieve states from the inefficiencies of collecting from their residents?
Polling Question #2

Did *Wayfair* establish a “new” bright-line rule to determine when a person has nexus with the state?

- Yes, when the person satisfies the $100K / 200 transaction threshold.
- No, the Court adopted a facts-and-circumstances test, it just so happens the retailers in *Wayfair* had nexus under South Dakota’s threshold.
- Probably not, but the states will interpret the South Dakota standard as the bright-line rule anyway.

Do a Tax Law’s Burdens on Taxpayers Exceed the Benefits to the State?

► *Wayfair* eliminated any doubt as to the relevance to tax laws of the balancing test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970): The test applies.

► Will this be argued in expected challenges to California’s pursuit of certain marketplace sellers for prior periods (Rev. & Tax. Section Code 6487.07)?
“Or” or “And”?

► Some states do not impose economic nexus until a remote seller’s sales satisfy both a dollar threshold and a transaction threshold.
► For example, New York requires sales of more than $500,000 AND more than 100 transactions.

The Commerce Clause – Nexus Issues After Wayfair...
Nexus Issues After *Wayfair* – Sales/Use Taxes

- Most states have adopted economic indicia modeled on South Dakota’s.
  - Does the same $100K/200 transaction threshold apply in every state?
    - The Kansas Department of Revenue asserts that its long-arm statute automatically adopted *Wayfair*—but because the Legislature has not adopted economic indicia, the Department asserts that a remote seller with a single sale to a purchaser in the state creates nexus. However, the Kansas Attorney General disagrees.

- If physical presence is not required to create nexus with the state, is it sufficient?
  - By overruling *Quill*'s physical presence test, did the Court also overrule *National Geographic*?

Polling Question #3

If physical presence is not *required* to create nexus, is it *sufficient*?

- Yes, any physical presence that satisfied *Quill* will still create nexus after *Wayfair*.
- No, having any physical presence without satisfying the economic thresholds will not create nexus.
- Maybe—a single employee in the state whose responsibilities are entirely detached from the taxpayer’s sales is not sufficient to create nexus.
Consider: Are remote retailers treated worse than in-state retailers? See e.g. new Illinois law (S.B. 690) under which sales by remote retailers are taxed on a destination basis, but sales by in-state retailers are taxed on an origin basis. So if each delivers a taxable item to the same Illinois locality, a greater amount of tax may be imposed on sale by the remote retailer.

► The Massachusetts Superior Court dismissed a group of online retailers’ suit against the Department of Revenue’s “cookie nexus” regulation enforced as of October 1, 2017.

► The retailers alleged that the regulation violated the Commerce Clause because it was being enforced prior to Wayfair.
  ▶ The retailers also argued that “cookie nexus” is not physical presence and was not legal before Wayfair.

► The court found that the retailers failed to exhaust their administrative remedies.
  ▶ The court declined to exercise its discretion to resolve the matter because “it appears that the number of internet retailers affected by a decision in this case is relatively confined and the ruling would apply only to an eight-month period[.]”

Polling Question #4

Should states that included a “transactions” economic nexus threshold for sales/use tax retain it or get rid of it?

• Yes, retain it, because it is a good proxy for determining the presence of regular business activity in the state.

• No, because it is difficult to define and can be exceeded, even when the remote seller has only a very small dollar volume of sales, requiring the filing of minimal value returns.
Nexus Issues After Wayfair – Income Taxes

► Did Quill’s physical presence rule apply to income taxes?
  ▶ From a federal constitutional perspective, the answer seems to be no. See, e.g. J.C. Penney v. Wisconsin (1940); International Harvester v. Wisconsin (1944).
  ▶ From a state law perspective, the answer depends on the state’s definition of “doing business” or “engaged in business”-type provision.

► How might Wayfair impact state income tax nexus laws?
  ▶ At a minimum, expect states to use Wayfair as the vehicle to adopt specific economic nexus standards for income taxes.
  ▶ But what should the economic nexus standard be?
    ▶ Does the same $100K/200 transaction threshold satisfy the Commerce Clause for income tax purposes?
    ▶ Pike v. Bruce balancing test questions

Post-Wayfair Income Tax Nexus Statutory/Regulatory Activity

► Hawaii 2019 SB 495: Economic nexus for corporate income tax (200+ transactions into the state annually, or $100,000+ in gross income from in-state sources, presumed to have economic nexus beginning in tax year 2020)
► Washington 2019 SSB 5581: Reduced economic nexus threshold for B&O tax to $100,000+/yr., effective 1/1/2020
► Oregon 2019 HB 2164, 3427: Economic nexus standard for new “corporate activity tax” (gross receipts tax) with “factor-presence” nexus ($50,000+ property, $50,000+ payroll, $750,000+/yr. commercial activity, or 25% of any one factor), effective tax years beginning 1/1/2020
► Massachusetts reg 830 CMR 63.39.1: Guidance on corporate income tax nexus: “in-state sales activity” under Wayfair and $500,000+ annual sales threshold creates presumption of nexus, promulgated 10/18/2019
► Texas proposed amendment to franchise tax reg section 3.586: Economic nexus for annual gross receipts from business done in Texas of $500,000+, effective 1/1/2020
Post-*Wayfair* Income Tax Nexus
Statutory/Regulatory Activity (cont.)

► Philadelphia section 103 of business income & receipts tax (BIRT) regs:
  Economic nexus for $100,000+ in Philadelphia gross receipts in prior 12 months, effective tax years beginning 1/1/2019

► Pennsylvania DOR Bulletin 2019-14: Rebuttable presumption – corporate net income tax economic nexus for direct or indirect sales $500,000+/yr., eff. TY beginning 1/1/2010

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The Due Process Clause
Due Process Clause – General Considerations

► The earliest limitation on state taxing authority recognized by the U.S. Supreme Court was the Due Process clause.

► Due process requires “definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax.” See Miller Bros. v. Maryland (1954).

► Quill was important not only because it reaffirmed the physical presence standard for sales and use tax, but explicitly required that a “nexus” exist for both Commerce Clause and Due Process Clause purposes.
  ▸ The Wayfair Court did not overturn this holding in Quill but did state that the two restrictions “may not be identical or coterminous, but there are significant parallels” between the two.
  ▸ In theory, then, a taxpayer could have nexus for Commerce Clause purposes, but not Due Process Clause purposes.
  ▸ But in practice, is this ever likely to happen?

Due Process Clause – Sales Tax, Income Tax, and the Taxation of Trusts

► For income tax purposes, the Court has historically held that Due Process nexus is satisfied if the “the state has given anything for which it can ask return.” See J.C. Penney v. Wisconsin (1940).
  ▸ Does Wayfair disrupt this analysis?

► For sales tax purposes, if a remote seller makes a single sale into the state, and that sale exceeds the economic indicia under state law, does the remote seller necessarily have Due Process nexus with the state?
  ▸ Wayfair does not specifically address this question—nor does it address whether such a sale would be sufficient to satisfy Commerce Clause nexus.
  ▸ If Wayfair is read to affirm South Dakota’s law as applied to Wayfair, is this an open question?

► For purposes of the taxation of trusts, can Due Process nexus be satisfied by “economic” or “virtual” presence of the trust? The beneficiaries?
Polling Question #5

Did *Wayfair* change the test for establishing “due process” nexus?

- Yes
- No— *Wayfair* made no changes to the test for establishing “due process” nexus that was stated in *Quill*, even though it overruled the “physical presence” Commerce Clause substantial nexus

Public Law 86-272
Overview of P.L. 86-272

- P.L. 86-272: Prohibits a state from imposing a “net income tax” if the “only business activities” in the state is the “solicitation of orders . . . for sales of tangible personal property.”
  - By its plain language, P.L. 86-272 applies only to a “net income tax.”
  - Likewise, it only offers protection to sellers of “tangible personal property.”

P.L. 86-272 & Wayfair

- *Wayfair* specifically addresses sales and use taxes, while P.L. 86-272 specifically addresses income taxes.
- If the nexus rules differ for sales and use tax and income taxes, does *Wayfair* have implications for P.L. 86-272?
The Multistate Tax Commission - P.L. 86-272
Statement of Information Work Group

► Scope of the Project
  ▶ Consider the application of P.L. 86-272 to modern business activities.
  ▶ States that have not adopted thresholds to shield small businesses from tax may consider doing so if either the Commission or individual states conclude that P.L. 86-272 does not provide immunity to small sellers that utilize modern business tools.

► To date, the Work Group has primarily considered how the provisions of P.L. 86-272 apply to various business activities conducted via the Internet. It is work is still in progress.

► The Work Group has applied a two-step analysis to determine if the statute provides business immunity from taxation:
  ▶ Do business activities constitute the solicitation of orders for tangible personal property?
  ▶ If the activities extend beyond solicitation, do the activities take place entirely outside of the taxing state?
Consensus has developed regarding step 2: As a general rule, if an in-state customer interacts with the remote business’s website (i.e., does more than view static text or photos), the business has engaged in activities in the taxing state.

Key considerations:
- When a customer engages a seller’s website, the website transmits software or code to the user’s computer which is stored in the user’s computer for some period of time. The code serves to facilitate the interaction between the customer and the business.
- The interaction between the customer and the website is substantial in nature.
- The analysis in Wayfair speaks to the “continuous and pervasive virtual presence of retailers” in the states where their customers are located.

Seller maintains a website offering for sale only items of tangible personal property. The products are complicated to use and purchasers often need post-sale assistance. Seller provides assistance in only one of the following ways:
- Seller identifies a toll-free number on its website, and purchasers may call the number to speak to a customer assistance representative (who is located out of state).
- Purchasers may either email or engage in electronic chat sessions with a customer assistance representative through the seller’s website.
- Seller’s website includes an interactive tool which allows customers to type in a question. In response, the system (without human intervention) either asks follow-up questions or provides an answer.
- Suppose that a state determines that customer support through a toll-free number does not occur within the state of the purchaser; alternatively, when the purchaser interacts through the seller’s electronic chat tool, that activity does occur within the taxing state.
The Intersection of P.L. 86-272, *Wayfair* & the Internet Tax Freedom Act (cont.)

- Internet Tax Freedom Act: Prohibits states from imposing, among other things, a “discriminatory tax,” including a tax that “imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means.”

- Unlike P.L. 86-272, the ITFA broadly defines “tax” such that it applies to “any charge imposed by any governmental entity for the purpose of generating revenues for governmental purposes, and is not a fee imposed for a specific privilege, service, or benefit conferred.”

- Is this a “discriminatory tax” under the Internet Tax Freedom Act? Could the seller avoid engaging in an in-state activity—and therefore still operate within the bounds of P.L. 86-272—if the customer support is provided over the phone?

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- The New Jersey Tax Court held that the state’s alternative minimum tax (the AMA) (repealed after January 1, 2018) is preempted by P.L. 86-272.

- The court characterized the AMA as a *de facto* Corporation Business Tax.

- Out-of-state companies that claim P.L. 86-272 protection could be entitled to AMA refunds for tax years after June 30, 2006, and prior to January 1, 2018.
Polling Question #6

Did *Wayfair* effectively repeal P.L. 86-272?

- Yes, P.L. 86-272 is no longer a valid federal law because it was effectively repealed as a result of *Wayfair*.
- No, *Wayfair* only addressed the constitutional nexus standard and did not impact any existing federal laws related to nexus.
- Not sure, what is P.L. 86-272?

Doing Business Standards
### Reconciling California’s “Doing Business” Standard

|--------------------|------|----------------------------------------------------------------------------------|

#### FTB Continues Broad Interpretation


- Members of an LLC are “generally considered” to be doing business in California, not always
- 15% non-managing interest in a California LLC (retained example)

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### Arizona Challenges California’s “Doing Business” Standard

- Motion for Leave to File Bill of Complaint, Bill of Complaint, and Brief in Support, Arizona v. California, No. 22O150 (Mar. 4, 2019)
- Arizona challenges California’s policy of extraterritorial assessment and enforcement of its $800 annual LLC tax and $800 minimum corporate franchise tax.
- “California is effectively exercising its taxing and police powers directly in Arizona as if the Colorado River had been shifted 300 miles to the east.”

#### Due Process Clause Violation

- Minimum contacts standard not met through a passive investment in a LLC or corporation.

#### Commerce Clause Violation

- All of Complete Auto’s four-prongs are not met.

#### Fourth Amendment Violation

- California’s seizures of out-of-state bank accounts, issued without a warrant or other judicial involvement, are unreasonable.
Marketplace Facilitator Laws & Litigation

Marketplace Collection Requirements... So Far

As of November 12, 2019

- Marketplace collection requirement
- Proposed legislation
- Collect-on-report
- No Sales Tax
- Sales >$10,000/yr
- State policy pending
- Policy/Lawsuit and Proposed legislation

Alaska
Hawaii
District of Columbia
On April 25, 2019, the MTC’s Uniformity Committee approved a new project to reconvene the Work Group to address follow-up issues arising from economic nexus and marketplace legislation.

- Focused on implementation and compliance.

Work Group identified “top 13” issues by priority, held teleconferences Aug-Oct 2019 to discuss each issue.

The Work Group developed draft white paper for consideration at the Committee’s November 2019 meeting, to be published on MTC website at www.mtc.gov.

### 2019 “White Paper” prioritized issues:
- Definition of marketplace facilitator/provider
- Who is the retailer
- Remote seller and marketplace seller vs. marketplace facilitator/provider recordkeeping, audit exposure and liability protection
- Marketplace seller-marketplace facilitator/provider information requirements
- Collection responsibility
- Marketplace seller economic nexus threshold
- Remote Seller sales/use tax economic nexus threshold
- Certification requirements
- Information sharing
- Taxability determination
- Return simplification
- Foreign sellers
- Local sales/use taxes
Louisiana – Online Marketplace Required to Collect


► The Louisiana Fifth Circuit Court of Appeal held that Walmart.com is a “dealer” required to collect and remit sales tax on sales made through its online marketplace, including sales by third party retailers.

► The court agreed with the lower court’s finding that the “legislature’s choice of the term ‘dealer’ and its definition clearly encompasses a wider group of people than ‘seller.’”

► Appeal pending with the Louisiana Supreme Court.

California – Going After Amazon as a Retailer


► An owner of a small business claims that the California Department of Tax and Fee Administration (CDTFA) has failed to compel Amazon.com to pay sales taxes on its past marketplace sales—at least 3 and up to 8 years before the Complaint filing.

► The owner is not an Amazon.com vendor.

► The owner alleges that the CDTFA should have deemed Amazon a retailer and not a marketplace and compelled it to pay sales tax.

► The Complaint was filed under California’s government waste laws.
Arkansas – Uber Eats Challenges A&P Tax


► The Arkansas Circuit Court granted Uber Eats’ Motion to Dismiss, finding that the Little Rock Advertising and Promotion Commission failed to state facts showing that it is entitled to relief.

► The Commission asserted that Uber Eats’ operations in Little Rock should be shut down until the company complies with the city code and obtains an advertising and promotion (A&P) tax permit.
  ▶ The Commission claimed that Uber Eats is subject to the Prepared Food Tax – a 2% tax on a restaurant’s gross receipts.
  ▶ The Prepared Food Tax applies to restaurants and other similar establishments that sell food. The Prepared Food Tax was recently expanded to platforms that sell food.

Arizona – OTCs Are Hotel Operators


► The Arizona Supreme Court found that online travel companies (OTCs) are “brokers” engaged in the business of operating hotels.

► Thus, the OTCs’ proceeds—their services fees and markups—are taxable gross income subject to municipal privilege taxes.

► The dissent warns that “[t]he opinion today changes the status quo and requires these agents [OTCs], credit card companies, and others to secure licenses and pay municipal taxes for the privilege of ‘operating hotels[.]’”
Polling Question #7

Have all states adopted marketplace collection laws?

- Yes, every state has adopted a marketplace collection law.
- No, there are still a few states that have not adopted a marketplace collection law.
- Not sure, I dozed off.

A Global Comparison
Online Marketplaces

► Similar efforts regarding online marketplaces are also occurring outside the U.S.

► UK and other EU member states have been introducing measures to ensure that overseas sellers selling goods in the UK via online marketplaces pay VAT on those goods.
  ▶ In 2016 the UK introduced legislation which made online marketplaces jointly liable with a non-UK seller for UK VAT.
  ▶ The legislation was extended in March 2018 for UK sellers.

Online Marketplaces (cont’d)

► Beginning in March 2018 new UK legislation allows HM Revenue and Customs (HMRC) to hold the operator of an online marketplace jointly and severally liable for unpaid VAT of non-UK sellers operating on its marketplace if certain conditions are met.

► Beginning in 2021, large online marketplaces will become responsible for ensuring that VAT is collected on sales of goods by non-EU companies to EU consumers taking place on their platform.

► HMRC has invited online marketplaces to sign up to an agreement to promote VAT compliance, but the agreement requires the marketplace to disclose a lot of data to tax authorities.
Polling Question #8

Please rate the *Limits on State Taxation in a Post-Wayfair World* webinar:

- Exceed my expectations
- Met my expectations
- Partially met my expectations
- Did not meet my expectations
- Other

FOR FURTHER INFORMATION

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