



Taxing the Cloud: Nexus and Sales Tax

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- Evolving Sales Tax Nexus
- Update on Federal Nexus Legislation
- Taxing the Cloud and Digital Goods
- What Can We Expect





Sales & Use Tax Nexus

- Nexus - a minimum connection or presence that must exist before a state can impose any tax liability and compliance requirements on a company
- *Quill Corporation v. North Dakota (1992)* - defined Fed limits on state authority
 - Due Process Clause - economic presence = minimum contacts test (e.g., sales in a state)
 - Commerce Clause - physical presence = substantial nexus test
 - What constitutes physical presence?



What Is Substantial Nexus?

- Since *Quill*, states' decisions as to what constitutes physical presence often conflicting
 - Reasons = each case has unique facts, agency laws, results-oriented approach, evolution of aggressive state tactics
- Taxpayers left in quandary as to what activities and what level of activities are safe
- States exploit the lack of guidance through nexus questionnaires



What is Substantial Nexus?

Physical presence includes:

- Offices or tangible personal property
- Employees or Contractors - doing anything at all!
- Delivering goods in company vehicles
- Storing Inventory (Amazon FBA retailers)
- Regular, even Sporadic visits
- Trade Shows - Exhibiting / Orders, even Attending
- Data or space on a server or a network of servers
- Owning/licensing software to customer - TX (SAaS?)
- Virtual Presence - “cookie nexus” (MA)



What is Substantial Nexus?



Trend is To Adopt Far-Reaching Nexus Standards

- Agency - attribute nexus of agent to remote seller
 - *Tyler Pipe* - SCt sanctioned this on basis that agent enables remote seller to establish or maintain a marketplace in that state
- Click-Through / Affiliate Nexus standard - attributional
 - *Click-Through Nexus*: AR, CA, CO, CT, GA, ID, IL, KS, LA, ME, MI, MN, MO, NV, NJ, NY, NC, OH, PA, RI, TN, VT, WA
 - *Affiliate Nexus*: AL, AR, CA, CO, DC, FL, GA, ID, IL, IA, KS, LA, ME, MD, MI, MO, NE, NV, NY, ND, OH, OK, PA, RI, SC, SD, TN, TX, UT, VA, WV, WA
- Notice/Reporting standard - forced compliance
 - Notice/reports to buyers and state: AL, CO, KY, LA, OK, PA, RI, SD, TN, VT, WA, GA (1/19)
 - Penalties for noncompliance can be > sales tax at issue (min. \$20K)



What is Substantial Nexus?

States impose economic nexus standards for sales tax nexus (no physical presence required)

- SD law: >\$100K in sales or 200 transactions creates nexus, ruled constitutional by US SCt
- *South Dakota v. Wayfair, Inc.* - (USSCt 6/21/18)
 - *Quill* overturned - no physical presence required and no bright line nexus standard
 - Applies to all remote sellers, not just online sellers
 - Will states enforce retroactively?
 - Will more states adopt economic nexus standards?
 - Will states seek to enforce existing nexus standards?
 - Everyone agrees Congress must create simple standards with small biz threshold - DON'T HOLD YOUR BREATH



What is Substantial Nexus?

➤ Economic Nexus

- 12 states - SD, HI, IL, IN, IA, KY, LA, ME, ND, RI, VT, WY
- >\$100K annual sales or 200 transactions
- 7 states - AL, CT, GA, MA, MS, OH, TN
- Prospective application only
- SD, IN, IA, KY, ND, RI, VT, WY - SSTP



➤ Marketplace Standard w/ Economic Nexus

- 8 states - OK, PA, RI, WA (AL, CT, IA, MN soon)
- Amazon collecting for all sellers in OK, PA, WA

➤ Currently HI, KY, ME, MA and RI enforcing



What is Substantial Nexus?

➤ Existing Nexus

- This leaves 23 states that may have to address this legislatively, or administratively, prior to requiring remote sellers to collect sales tax on sales to customers in their jurisdiction.
- Several states currently limit nexus to physical presence (e.g., MD)
- However, many states have broad, “catch-all” definitions for what constitutes “doing business” (i.e., having nexus) in the state (e.g., CA, TX)



What is Substantial Nexus?

➤ What Can We Expect?

- Nexus Free For All? Patchwork of different standards and thresholds from state to state
- Heightened enforcement of existing nexus laws
- More economic nexus standards
- Potential for virtual nexus provisions (e.g., cookies)
- States begin taxing more services
- Retroactive Application of new nexus laws
- Lower thresholds
- Lawsuits challenging the constitutionality of state nexus provisions



What is Substantial Nexus?

➤ What Can We Do?

- Physical Presence still creates nexus - inventory (FBA), attributional (click-through, affiliate)
- This applies to ALL sellers, inc. SAaS, services
- Review historical sales (\$ and #) by state
- Review / monitor state nexus standards
- Review nexus creating activities under existing laws
- Register where nexus exists or risk of nexus is material
- Resolve any historical exposure proactively
- Implement sales tax compliance software
- Track prospective sales (\$ and #) by state



States Enforcing Economic Nexus

South Dakota Economic Nexus		Prospective v. Retroactive	Sales \$ Threshold	Sales # Threshold	SSTP State	Notice and Reporting	Notes
SD*	5/1/16	Prospective	\$100,000	200	Yes	notice and reporting	delayed
HI	7/1/18	Prospective	\$100,000	200	No		intends to enforce 7/1/18
IL	10/1/18	Prospective	\$100,000	200	No		
IN*	7/1/17	Prospective	\$100,000	200	Yes		delayed
IA**	1/1/19	Prospective	\$100,000	200	Yes		intends to enforce 1/1/19
KY	7/1/18	Prospective	\$100,000	200	Yes	notice and reporting	intends to enforce 7/1/18
LA*	6/21/18	Prospective	\$100,000	200	No	notice and reporting	delayed
ME	10/1/17	Prospective	\$100,000	200	No		
NJ - introduced	pending	Prospective	\$100,000	200	Yes		legislation introduced
ND	10/1/18	Prospective	\$100,000	200	Yes		intends to enforce 10/1/18
RI**	8/17/17	Prospective	\$100,000	200	Yes		
VT	6/21/18	Prospective	\$100,000	200	Yes	notice and reporting	intends to enforce 7/1/18
WY*	7/1/17	Prospective	\$100,000	200	Yes		
Other Economic Nexus		Prospective v. Retroactive	Sales \$ Threshold	Sales # Threshold	SSTP State	Notice and Reporting	Notes
AL*	1/1/16	Prospective	\$250,000	none	No	notice and reporting	
CT	12/1/18	Prospective	\$250,000	200	No		
GA	1/1/19	Prospective	\$250,000	200	Yes	notice and reporting	
MA**	9/22/17	Prospective	\$500,000	100	No		
MS*	12/1/17	Prospective	\$250,000	none	No		
OH*, **	1/1/18	Prospective	\$500,000	none	Yes		
TN*	1/1/17	Prospective	\$500,000	none	Yes	notice and reporting	
Marketplace Nexus		Prospective v. Retroactive	Sales \$ Threshold	Sales # Threshold	SSTP State	Notice and Reporting***	Notes
AL	1/1/19	Prospective	\$250,000	none	No		
CT	12/1/18	Prospective	\$250,000	200	No		
IA	1/1/19	Prospective	\$100,000	200	Yes		
MN*	6/21/18	Prospective	\$10,000	none	Yes		
OK	7/1/18	Prospective	\$10,000	none	Yes	notice and reporting	Amazon collecting for all sellers 7/1/18
PA	3/1/18	Prospective	\$10,000	none	No	notice and reporting	Amazon collecting for all sellers 4/1/18



Notice & Reporting States

Notice & Reporting	Eff Date	Prospective v. Retroactive	Sales \$ Threshold	Sales # Threshold	SSTP State	Notice and Reporting****	Notes
AL	7/1/17	Prospective			No		AL focusing on marketplace facilitators; sellers subject to economic nexus which is delayed
CO	7/1/17	Prospective	\$100,000	n/a	No	1. Provide notice at time of sale; 2. by 1/31 of each year send report to each purchaser >\$500; 3. by 3/1 of each year, send report to DOR of sales to customers who purchased >\$500	CO aggressively enforcing; register if you exceed thresholds; apples to affiliated of controlled group
GA	1/1/19	Prospective	\$250,000	200	Yes	1. Provide notice at time of sale; 2. by 1/31 of each year, send report to DOR of sales to customers who purchased >\$500	no guidance yet; nontaxable sales included in threshold
KY	7/1/18	Prospective	\$100,000	n/a	Yes	notice on website	no penalties for noncompliance yet; nontaxable sales included in threshold
LA	7/1/17	Prospective	\$50,000	n/a	No	1. Provide notice at time of sale; 2. by 1/31 of each year send report to each purchaser; 3. by 3/1 of each year, send report to DOR of sales to customers	LA aggressively enforcing; register if you exceed threshold; penalties have not been established; nontaxable sales included in threshold
OK	7/1/18	Prospective	\$10,000	n/a	Yes	1. Provide notice on site and at time of sale; 2. by 1/31 of each year send report to each purchaser; 3. by 3/1 of each year, send report to DOR of sales to customers	OK aggressively enforcing; register if you exceed thresholds; penalty for noncompliance is minimum of \$20K or 20% of prev. 12 mos sales for each instance
PA	3/1/18	Prospective	\$10,000	n/a	No	1. Provide notice on site and at time of sale; 2. by 1/31 of each year, send report to DOR of sales to customers	PA aggressively enforcing; register if you exceed thresholds; penalty for noncompliance is minimum of \$20K or 20% of prev. 12 mos sales for each instance
RI	1/1/18	Prospective	\$100,000	200	Yes	1. Provide notice on site and at time of sale and within 48 hrs of sale; 2. by 1/31 of each year send report to each purchaser >\$100; 3. by 3/1 of each year, send report to DOR of sales to customers	RI aggressively enforcing; register if you exceed thresholds; penalty for noncompliance is minimum of \$10K or \$10 for each instance
SD*	7/1/11	Prospective	\$100,000	n/a	Yes	provide notice at time of sale	no penalties for noncompliance; nontaxable sales included in threshold
TN	3/26/12	Prospective		n/a	Yes	n/a	
VT	7/1/17	Prospective	\$1	1	Yes	1. Provide notice at time of sale; 2. by 1/31 of each year send report to each purchaser >\$500; 3. by 3/1 of each year, send report to DOR of sales to customers who purchased >\$500. Sellers < \$100K exempt	VT has ZERO threshold notice reqs law however penalties are \$5 per sales notice infraction and \$10 for failure to file report; there are reporting thresholds of \$500 per purchaser and \$100k in sales
WA	1/1/18	Prospective	\$10,000	n/a	Yes	1. Provide notice on site and at time of sale; 2. by 2/18 of each year send report to each purchaser; 3. by 3/1 of each year, send report to DOR of sales to customers and affidavit of compliance	WA aggressively enforcing; Penalties: no platform notice - \$20K; no notice at time of sale - \$20k; failure to provide customer annual report - \$5k - \$100k based on volume; failure to provide DOR annual report - \$25 per customer, min \$20k

*challenged or delayed - effective date may be 6/21/18 or 7/1/18



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MEETING OBLIGATIONS, EXCEEDING EXPECTATIONS

Update on Federal Nexus Legislation





Streamlined Sales Tax Agreement

- Collaborative effort of NGA, NCSL, states and business to simplify sales and use tax laws, minimize costs and administrative burdens on retailers that collect sales tax, and encourage "remote sellers" to collect tax on sales to customers living in the Streamlined states.
 - 24 states have adopted Streamlined Sales Tax Code
- How does Streamlined SUTA attempt to simplify sales tax administration?
 - uniform definitions, uniform and simpler exemption administration, one rate per state, state-level administration of all sales taxes, uniform sourcing (where the sale is taxable) and state funding of the administrative cost



Federal Sales Tax Nexus Legislation

- Marketplace Fairness Act (S.976, 4/17)
- Remote Transaction Parity Act (HR 2193, 4/17)
- Allow **qualifying** states to require remote sellers to collect tax on sales made to customers in the state
 - States must conform to SSTEP or model statute
- Does not change physical presence nexus standard
- Sellers may choose sales tax solution provider
- Small Business Exemption: MFA - retailers < \$1M in annual remote sales; RTP - < \$10M, then \$5M, then \$1M, then 0



Taxation of the Cloud and Digital Goods



Taxation of the Cloud and Digital Goods

Taxation of the Cloud

- Internet Access
- Software
- Services
- Digital Goods



Taxation of the Cloud and Digital Goods

Taxation of Internet Access

- Provision of Internet Access is currently exempt from taxation under the Internet Tax Freedom Act.
 - Taxation permitted - HI, NH, NM, ND, OH, SD, TN, TX, WA and WI.
- Amendments of 2007 also exempted Internet backbone services (telecom) purchased by ISPs
- Indefinite extension



Taxation of the Cloud and Digital Goods

Taxation of Software

- Custom software typically not taxed
- Canned (prewritten) software provided in tangible media, even as a back-up is typically taxable
- Canned software delivered electronically
 - Sales tax imposed on Tangible Personal Property
 - Several states exempt canned software delivered electronically, typically because it is not TPP - AR, CA, CO, FL, GA, IA, MD, MO, NV, OK, SC, VA
 - This exemption erased if any tangible product included in sale.



Taxation of the Cloud and Digital Goods

Cloud Computing

- Software As a Service (SAaS) - remotely accessed
 - Is it software? data processing? information service?
- Infrastructure As a Service (IAaS) - virtual hardware, storage
 - Is it leased TPP? Is it a service?
- Platform As a Service (PAaS) - customer develops own apps using provider's operating system, tools and SAaS (e.g., Google App)
 - Is it software? data processing? information service?



Taxation of the Cloud and Digital Goods

Digital Goods

- Downloaded products that states typically tax or don't in a physical media
- Downloaded products that do not have a similar physical media state states have historically addressed
- Online services - streaming A/V (Netflix, Spotify), gaming, information services, dating, security, Telematics (M2M)
- iTunes and Google Play –90% of all apps
 - iTunes - price includes sales tax, based on bill-to address
 - Google Play - “Google may not be the seller of record and therefore individual sellers are responsible for determining applicable sales taxes”



Taxation of the Cloud and Digital Goods

Declining Tax Base

- As more products shift from tangible to a digital format, the sales tax base will continue to decline and states will not be able to afford the same level of services currently provided.
 - Consequence - reduce services, increase tax rates on items already taxed or broaden tax base to include digital goods and services
 - If states tax, should do so statutorily, not by broadening interpretation of tangible personal property to include digital



What Can We Expect...

- Nexus - efforts to increase the size of the pie
 - Increased enforcement of existing laws
 - More economic nexus standards
 - More virtual presence provisions
- Services, Services, Services
 - All services - expect expansion
 - More state attempts to cloud, digital goods & services
 - Problems: classification / sourcing
- SSTP and MFA / RTP
 - Don't hold your breath!





QUESTIONS?



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MEETING OBLIGATIONS, EXCEEDING EXPECTATIONS

Thank You!

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