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Article | September 27, 2021

Do You Know Your Nexus?

A primer on the impact of *Wayfair* on cross-border sales taxes

The U.S. Supreme Court's *South Dakota v. Wayfair* decision was pivotal to sales tax administration - and its impact continues to emerge. Overturning precedent, the Court ruled that South Dakota could require sales taxes to be gathered and paid by vendors for purchases made from within the state, even if the company had no physical presence in the state. Wayfair greatly impacted taxation for businesses operating across states. And since the decision was passed in 2018, states have tested its boundaries, creating risk and uncertainty for companies operating across state lines.

In this article, we'll help you understand the Wayfair case and its impact, and answer some common questions about nexus legislation and how its various iterations may apply to your organization.

On June 21, 2018, The United States Supreme Court ruled 5-4 in *South Dakota v. Wayfair* that South Dakota can collect sales taxes from businesses that pass a certain sales threshold (more than 200 transactions or $100,000 in sales within the state) *even* if the business has no physical presence in the state. This decision abrogated (overturned, or repealed) the Court's 1992 decision in *Quill Corp. v. North Dakota*.

The Quill case held that the Dormant Commerce Clause barred states from allowing retailers to collect sales taxes unless they were present in that state. However, after that case closed in 1992, the volume of interstate sales grew rapidly, primarily in the form of e-commerce transactions.

The Quill decision was in need of serious review. More than 20 states passed “kill Quill” legislation. Supported by the National Retail Federation along with 40 other states that joined its petition, South Dakota's case was the first to make it through to the Supreme Court. South Dakota won with a 5-4 vote among the Supreme Court justices, overturning Quill.

Since then, most states in the U.S. have enacted economic nexus provisions, many with legislation similar to South Dakota's.

“Nexus” defines how a business and a state are connected

Economic nexus legislation generally requires an out-of-state seller to collect and remit sales tax once the seller meets a threshold of sales transactions within the state — without a physical presence being required. Nexus almost always applies to businesses selling tangible, physical products (e.g., not services businesses). Different states set different thresholds and rules on which annual revenue amounts, number of shipments, or types of sales are considered.

Some states define exemptions, in which case businesses are often required to provide proof their sales are exempt. If proof is not offered and accepted, sales are automatically counted as taxable. And again, each state makes its own decisions on how to apply sales tax, so each state has its own criteria for meeting exemptions.
Thresholds and exemptions - and each varies by state?!
For any business selling physical goods across state lines, nexus is definitely complicated. Many states are acting on a 'nexus until proven otherwise' presumption. For example, a state may extrapolate that your company has nexus if it's similar to other businesses with confirmed nexus already on file with the state.

In other words, it is often the case that each business is presumed to owe state tax unless it submits documentation supporting otherwise. The documentation often includes a nexus questionnaire that the state uses to determine the taxes they can assess.

It's important that businesses complete these questionnaires carefully and accurately - we highly recommend expert guidance. Careless filing could lead to a whole host of problems, as some states go to incredible lengths to adjudicate and enforce sales tax collection. Further, some states impose maximum penalties on a business, even after full cooperation with fulfilling outstanding obligations. Their pursuit can be aggressive, with no concern over whether a business can survive the new taxation.

Retroactive application of cross-state sales tax

One of the most pervasive arguments for overruling Quill was that states would not apply sales tax retroactively. In other words, states would not be able to look back and require collection and remittance of sales tax on previously purchased items. However, many states changed their minds after the Court's decision was made in favor of South Dakota.

For example, later in 2018 - the same year Wayfair was decided - the state of Florida argued that the ruling should be retroactively applied to a case. This scenario introduced the concern that other states would test just how far back they could audit and apply tax assessments. Many of the businesses in question never filed a sales tax return for that state, and to date, there's no federally-mandated limit on how far back a state can go in pursuit of assessment. Theoretically, a state could request taxes for transactions all the way back to when a company first had nexus within the state.

Determining your company's potential post-*Wayfair* sales taxation

Define where and whether nexus applies to assess your company's potential taxation as a result of the Wayfair ruling, first determine if you established (or should have established) nexus under one of the pre-*Wayfair* provisions. Some businesses may have had nexus even before the state enacted its remote-seller nexus provision. Further, even if all of your sales are exempt, you may still have a filing requirement and potential exposure. Remember, exemption qualification varies across states, and if requirements are not met everywhere, you may be left responsible for the disallowed exempt sales.

Next, for each state to which you sell, determine if your sales are taxable:

1. Is the property, product, or service specifically listed as being subject to the state's sales tax?
2. If so, does an exemption or exclusion apply?

Remember that exemptions can work differently from state to state. It's important to determine the taxability and possible exemptions for each state into which your company is selling. Where nexus is applicable, calculate sales tax responsibilities

Now that you know where you have a collection responsibility and which of your products are taxable, it's time to make sure you have a complete understanding of your company's sales tax responsibilities.

When it comes to exemptions, remember that states often require documentation to prove that you qualify. You should look into whether each state requires their own form or if they accept a multistate form. Make sure to include all the information needed and verify how long any certifications are valid.

It's also important to ensure proper processes for recording and sourcing sales are in place. The information you'll need to meet your sales tax obligation should be captured through these processes. This includes information such as purchase price, sales tax collected, and ship-to locations.

Get on track with sales tax returns

After registering with the state for collection and remittance, you'll need to prepare and file sales tax returns. Most states require newer businesses to file these monthly. They're commonly done electronically and aren't overly complicated. If the proper sales information is gathered throughout the month, it's relatively easy to use automated solutions to convert the information into the correct format for your business's tax return software.

All of these steps help you prevent noncompliance. Businesses that don't evaluate their prior exposures (or choose not to register and file at all) can certainly face consequences. Potential criminal penalties are not unheard of, and many states have them included in their statutes for businesses that do not remit sales tax. Some states also impose them on individuals who knowingly fail to file their tax returns.

States across the country are jumping on the nexus train, and it's imperative that businesses have a clear understanding of the topic and the risks of ignoring these laws. And with many states following the 'nexus until proven otherwise' presumption, companies should take immediate action if they want to file for exemption. The longer you wait to act, the more potential liabilities will grow.

Need more information on economic nexus legislation or sales tax?

Visit us at CereTax.com or contact us for guidance