

The US sales & use tax landscape

Why non-US businesses need to care

January 2018

The state of South Dakota has petitioned the US Supreme Court with the hope that the Court will revisit the question of sales and use tax nexus standards and determine that physical presence in a state is no longer necessary. Non-US businesses need to understand the potential implications of this case.

Sales and use tax laws in the US are increasingly becoming an acceptable topic of dinner conversation, and not just for those in the business of understanding them. States are making headlines for enacting new laws and regulations related to remote sellers and marketplace platform providers in an attempt to collect tax on sales to customers in their state. The uncertainty around who is responsible for collecting and remitting tax on such internet sales impacts both domestic US and international online marketplaces and sellers.

This article is intended to assist non-US businesses understand recent developments in state sales and use tax nexus standards, and consequently, their potential collection and remittance obligations, as well as highlight the states in which collecting tax without a true, in-state physical presence may be necessary. Hereinafter, any reference to "tax" is intended to mean sales and use tax.

Current US jurisprudence and sales and use tax nexus standards

States attempted to recoup what they consider "lost revenue" due to the increasing popularity of mail-order sellers over 50 years ago. To better understand the provisions states have imposed over the past few years, it is important to first provide a brief overview of current law.

Under current US Supreme Court law, a seller must have a physical presence in a state before that state may impose collection and remittance requirements. In its 1992 decision, *Quill Corp. v. North Dakota*, 504 US 298 (1992) ("Quill"), the US Supreme Court affirmed the holding in *National Bellas Hess Inc. v. Illinois Dept. of Rev.*, 386 US 753 (1967) ("Bellas Hess") creating a safe harbor for remote sellers.

Thus, from a US Constitution perspective, remote sellers cannot be required to register to collect and remit sales taxes so long as there is no in-state physical presence. Arguably, tax is still due on the goods they sell, but the individual customer is the one with the obligation to remit the tax directly to the tax authority. Understandably, there is little compliance with this potential obligation among individual consumers. To address this perceived compliance issue, states have, over time, tried to expand the definition of what constitutes a physical presence so as to require sellers to collect a greater proportion of the tax.

Affiliate or attributional nexus

States have taken various positions to counter the physical presence requirement, starting with affiliate or attributional nexus standards. Twenty-one states, and Puerto Rico, either legislatively or administratively impose affiliate or attributional nexus standards, which essentially state that although an out-of-state seller may not have physical presence within the state itself, the in-state physical presence and activities of an affiliate or unrelated party may be attributed to the out-of-state seller. Although this may seem to exceed the reach of *Bellas Hess* and *Quill*, the US Supreme Court noted in *Tyler Pipe Industries, Inc. v. Wash. State Dep't of Revenue*, 483 US 232 (1987) that an in-state party might create nexus for an out-of-state seller if the in-state party's actions are "significantly associated with an out-of-state seller's ability to establish and maintain a market for sales in the state." There is no bright-line test of what constitutes "significantly associated with an out-of-state seller's ability to establish and maintain a market." Thus, the activities of a third party should be closely monitored to determine if it is creating a market for the out-of-state seller and could be used to assert a collection obligation on the seller.

Click-through nexus

States began enacting “click-through” nexus provisions, directed more specifically at internet sellers. These laws, which have been adopted in 21 states and Puerto Rico, impose a sales tax collection obligation upon sellers without an in-state physical presence by asserting nexus over an out-of-state seller that has an agreement with an in-state entity under which the in-state entity makes referrals of potential customers to the out-of-state seller (generally by a weblink on the in-state entity’s website) and then pays a commission to the in-state entity for a completed sale. The click-through nexus statutes generally provide that an out-of-state internet seller is presumed to be soliciting business in state, directly or indirectly, through the in-state independent contractor or other representative. Such presumptions typically only apply if the out-of-state internet seller exceeds, under that state’s laws, a threshold amount of sales into the state in the previous year. There is also the ability to try and rebut the presumption by demonstrating, generally by a signed written statement, that the in-state person did not act on behalf of the seller by engaging in solicitation activities that would satisfy the nexus requirements of the US Constitution.

US tax notice and reporting requirements

States have also tried to address the perceived loss of tax revenue by enacting certain reporting requirements for out-of-state sellers to make purchasers aware of their potential obligation to remit use tax on purchases, assuming the out-of-state seller does not voluntarily collect and remit sales tax. Colorado first adopted such provisions in 2010, and the constitutionality of the state’s requirements was in flux until they were upheld by the US Court of Appeals for the Tenth Circuit in 2016. Alabama, Kentucky, Louisiana, Oklahoma, Puerto Rico, Rhode Island, South Dakota, and Vermont have also enacted use tax reporting requirements.

Use tax notice and reporting statutes generally state that the out-of-state seller is required to (1) provide the purchaser with a notice at the time of purchase informing it of its obligation to remit use tax, (2) send each customer an annual purchase summary with a reminder that the purchaser may owe use tax on its purchases, and/or (3) file an annual report with the Department of Revenue identifying its in-state customers, including their total purchases. These use tax notice and reporting requirements provide states with information on in-state purchasers, which allows the states to reconcile whether purchasers remitted use tax as required, or to pursue the collection of tax from the purchasers. Hypothetically, those purchasers would be more inclined to remit the tax with the additional reminders to do so. The states also hope that some sellers will choose to collect the tax themselves, rather than comply with the substantial reporting requirements.

Online marketplace providers

Instead of focusing on individual customers or internet sellers, a few states are turning their attention to the electronic platforms that facilitate remote sales by providing a platform for advertising, order and payment processing, or order fulfilment. Arizona, Minnesota, and Washington State have addressed, either legislatively or administratively, the collection of tax by such online marketplace providers. The South Carolina Department of Revenue has begun to litigate the marketplace issue by arguing, in part, that under South Carolina law, the marketplace provider is the party *making* the sale, not simply facilitating it.

Economic nexus

States have been working for over 20 years to convince the US Congress to take legislative action to eliminate the physical presence requirement and allow states, under certain conditions, to require remote sellers to collect tax on goods they sell into the state, regardless of whether they have a physical presence in the state. The prospect of Congress doing so in the near future does not seem likely. This fact, combined with the growing number of states that consider the physical presence requirement to be an antiquated standard, has led to an increase in the number of states taking it upon themselves to push the nexus boundaries, through adoption of economic nexus standards.

Economic nexus laws state that if an out-of-state seller makes sales into the state exceeding a sales or transaction threshold, the out-of-state seller has created nexus with the state, irrespective of whether it has a physical presence in the state. As a result, the seller has a tax registration, collection, and remittance obligation. The following states have adopted, either legislatively or administratively, economic nexus standards; Alabama, Connecticut, Indiana, Maine, North Dakota, South Dakota, Tennessee, Vermont, and Wyoming. At present, US constitutional law still requires a physical presence before a state may impose a tax collection obligation on a seller: therefore, most of these state laws do not become effective until/if the US Supreme Court overturns *Quill*.

South Dakota v. Wayfair, Inc.

In 2016, South Dakota became the first state to enact economic nexus provisions for sales and use taxes. The South Dakota law provides for a bright-line test, under which all entities with annual sales in South Dakota exceeding \$100,000, or with more than 200 separate transactions in the state in a calendar year, are required to register with the state to collect and remit tax. Though the South Dakota Supreme Court has ruled the law unconstitutional, the state has petitioned the US Supreme Court in the hope that the Court will revisit the question of sales and use tax nexus standards.

The Court has not done so since *Quill*. The US Supreme Court is not obligated to hear any case for which it is petitioned. As of the date of writing (January 2018), the US Supreme Court has not yet granted nor denied South Dakota's writ of certiorari. The cert petition was recently [distributed](#) to the Justices for conference on January 5, 2018. During conference, the Justices determine which (if any) petitions to grant. Unless the petition is rescheduled for a later conference, the outcome will be announced shortly thereafter.

If *Quill* is overturned and the US Supreme Court determines that physical presence for sales and use tax purposes is no longer the law of the land, it will have a huge impact on sellers who currently find shelter under the landmark case. The potential implications of this case may also affect non-US remote sellers for three primary reasons:

- US sales and use taxes are vastly different from value added tax ("VAT"), and therefore, non-US remote sellers may not be as familiar with US sales and use taxes;
- non-US businesses may currently not worry about collecting sales taxes if they do not have a physical presence within the state; and
- non-US businesses will need to register to collect and remit sales and use taxes in all jurisdictions to which they make sales.

In extreme cases, this change may affect and change the way non-US businesses conduct business within the US, if the cost of compliance becomes too burdensome.

Operational impact for non-US businesses

Regardless of the outcome of *South Dakota v. Wayfair, Inc.*, non-US sellers should review their activities and business relationships within the US to determine if they have created nexus through, for example, the nexus criteria described above. In addition, regardless of whether the physical presence standard is overturned, considering the potential operational impact outlined below may aid in mitigating potential noncompliance with current state guidance.

The following are some of the considerations to be aware of if a seller is required to collect tax because it has created nexus.

Sales and use tax registration

Before a remote seller can begin to collect sales tax on its taxable sales, it must first register with each state to collect and remit sales and use taxes. Registering with each state in which it has a compliance responsibility may be a change, as non-US businesses may be accustomed to the EU Mini One Stop Shop ("MOSS") scheme.

This article does not detail the intricacies of MOSS; however, generally, MOSS is only available to businesses providing business-to-consumer ("B2C") sales of telecommunications, broadcasting, and electronically supplied services. MOSS can be utilized regardless of where the business is established. EU businesses may utilize MOSS by registering in the country where their headquarters are located. Non-EU businesses may utilize MOSS by choosing *any* EU country in which to register to collect and remit VAT. Thus, the simplicity offered by MOSS allows companies to sell telecommunications, broadcasting, and electronically supplied services within the EU without the need to register in each EU country in which services are supplied.

Unlike the MOSS scheme, there is no central or universal registration process within the US; each state requires utilization of its own registration form. Some forms are more onerous than others.

Once registered, non-US businesses need to be aware of filing calendars and varying tax return due dates. While most tax returns are due on the 20th of the month, there are deviations, with some states requiring returns to be filed by the last day of the month, for example. Lastly, while nearly all states encourage electronic tax filing and payment, some states mandate it, imposing penalties for failure to do so. A few state-specific requirements include but are not limited to specified payment methods (Automated Clearing House or credit), specific submittal dates, or use of an approved tax software.

Taxability

In those states with a sales tax, the tax is typically imposed upon the sale of tangible personal property and only specifically enumerated services. The definitions of both concepts vary across states, and things get particularly tricky when a company sells software, software-related services, or digital goods. Sales of these items are difficult to categorize and, with that, may have different definitions depending on the state.

The next step is to identify whether the company's sales to customers in an individual state are taxable. Unfortunately, this, too, can prove difficult.

Determining taxability depends upon the item sold just as much as it does on the state in which the sale is made. There are many technology tools to assist with taxability determination; however, in order to operate effectively, the tools require accurate inputs of both what was sold and where the customer received the good. These tools can assist with determining if the sale is subject to sales and use tax in jurisdictions and which state and local tax rate to collect.

After determining taxability, the seller must now determine the rate at which to calculate sales tax. Forty-five states and the District of Columbia impose a sales tax, each with their own sales tax rate.

Additionally, many local jurisdictions impose a local sales tax. According to Vertex, a major tax and rate determination software supplier, it has been estimated that there are over 10,000 different tax rates within the US. Thus, it is important to determine the exact location of the customer in order to charge the correct sales tax rate.

Sales tax exemption certificates

As noted in the previous section, it is commonly presumed that sales of tangible personal property and certain services are taxable. The seller has an obligation to assess tax on a taxable sale. The onus is then shifted to the customer to provide any applicable exemption certificates or acceptable documentation noting that the seller should not assess sales tax. The thought is that the seller does not know how the customer will use the taxable product or service, and therefore, the customer must provide documentation to prove tax should not be charged. Typically, a seller is no longer liable to collect the tax otherwise due so long as a seller accepts the documentation in "good faith." The form should be completed according to state requirements, which typically include ensuring the certificate is signed, dated, and not expired.

Examples of commonly accepted certificates include those used when a customer will use the item purchased for an exempt activity, (e.g., manufacturing, construction, or mining), those to note that the customer is an exempt entity (e.g., government, education, and health-care providers), and certificates known as "direct pay permits," which mean the customer has been approved by the state to forgo paying vendor-assessed sales tax; instead, the customer has agreed with the state that it will self-accrue and remit use tax on its taxable purchases.

Business-to-business transactions

A seller making a sale for resale must be aware that procedures for a business-to-business ("B2B") transaction for US sales and use tax purposes differ from those for VAT. A B2B sale is not automatically exempt from tax. If, in a B2B sale, the purchaser is the end user, the sale is subject to tax assuming that it is a taxable sale. If, however, the purchaser will be reselling the items it purchases, then the transaction is typically not subject to sales and use tax, as most states have a specific exemption applicable to these sales (as noted above).

Imagine a large network of non-US businesses. Three related entities each make taxable sales to consumers within the US. It may appear logical that the entities may be able to register and remit on a consolidated basis—that is, one registration for all three entities and one return in each relevant jurisdiction.

Unfortunately, this would be incorrect, as sales and use taxes are generally collected and remitted on an entity-by-entity basis. It is important to keep in mind that US sales and use taxes follow the principles of form over substance. This means that each entity generally has a registration, collection, and remittance obligation. This may further muddy the waters for non-US sellers, as they may now be required to register multiple entities for sales and use tax purposes.

Data

Non-US businesses can better position themselves by validating the quality and integrity of their data. As often happens, audits boil down to the quality of data and the ability to produce supporting documentation. Non-US businesses should be diligent in maintaining certain data points. Some data elements to keep in mind include, but are not limited to:

- the location of the customer (city, state, and zip code);
- the taxability of the item sold;
- the sales tax rate at which the item (if taxable) was taxed;
- the amount of the sale;
- the amount subject to tax; and
- any exemption certificates or direct pay permits received.

What now?

Non-US businesses (and everybody else) will need to await the outcome of *South Dakota v. Wayfair, Inc.* If the US Supreme Court denies South Dakota's writ of certiorari, the *Quill* decision is still the law of the land and a seller must have an in-state physical presence in order to be required to register to collect and remit sales and use taxes. As discussed above, there are numerous ways a seller might meet this requirement. If the US Supreme Court does grant South Dakota's writ of certiorari, all eyes will be on the decision. The Court may or may not completely reverse *Quill*, could make a potential decision applicable only to states that have adopted economic nexus for sales and use tax purposes, or, once again, ask Congress to step in. In sum, there is no guarantee what the Court may do, even if it grants certiorari.

Contacts

Tim Gillis

Head of Global Indirect Tax Services
KPMG International
T: +1 202 533 3700
E: tgillis@kpmg.com

Authors

Harley Duncan

Managing Director, State and Local
Tax Washington National Tax
KPMG in the US
T: +1 202 533 3254
E: hduncan@kpmg.com

Raj Lapsiwala

Manager, State and Local Tax
Washington National Tax
KPMG in the US
T: +1 202 533 4020
E: rlapsiwala@kpmg.com

Angela Snaza

Manager, State and Local
Tax Washington National Tax
KPMG in the US
T: +1 202 533 3469
E: asnaza@kpmg.com

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