Sales Tax Hot Topics for CPAs

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Honored To Be Recognized As:
• “Women of Influence” by San Jose Silicon Valley Business Journal (2014)
Topics for Today

- General sales tax concepts/nexus
- Internet sales and “Amazon laws”
- VDAs and amnesty
- Sales tax for M&A
- Federal Activity
- Compliance issues
- Q & A
Sales tax is one of the most common taxes encountered everyday by businesses and consumers alike.
Polling Question #1
Your practice…
The concept of sales tax is prevalent in daily conversations because:

- States need revenue
- Increased **online transactions**
- Smaller companies are able to expand their sales footprints quickly because of increased technology.
Sales/Use Tax

• **Sales tax** and complementary **use tax** are imposed by state and local jurisdictions on retailers for the privilege of selling “tangible personal property” in the jurisdiction.

• 45 states and DC impose a sales tax.
Tangible Personal Property

- The term “tangible personal property” or “TPP” refers to property which can be seen, weighed, measured, felt or touched, or perceived by the senses.
- In general, unless otherwise exempt, sales of TPP are subject to sales tax.
Services

- Generally non-taxable unless specifically enumerated
- States are expanding taxable services
- Some examples (vary by state)
  - Data Processing
  - Information services
  - Certain repairs
Nexus

- “The sufficient connection that an entity must have in order for a state to impose a tax.”
- Generally physical contact between a taxpayer and state must occur.
- Defined by U.S. Constitutional principles and U.S. Supreme Court cases.
Nexus – OK! Now What?

- Once nexus is established, seller is obligated to collect sales tax.
- Unless there is a specific exemption.
Sales Tax Exemptions

- Due to the nature of the seller
- Due to the nature of the buyer
- Nature of the property/service transferred/performed
- Intended use by the purchaser
- Nature of the transaction
Our current system stems from various state statutes and regulations:

- From the U.S. Constitution:
  - Due Process Clause
  - Commerce Clause

- From U.S. Supreme Court Decisions in multi-jurisdictional cases:
In Quill, the U.S. Supreme Court concluded that in addition to any minimum connection with a state (Due Process Clause), a business must have substantial physical presence nexus (under the Commerce Clause) before the state could impose sales/use tax collection requirements.
Catalog vs. the Internet

- Internet: Non-existent when *Quill* decided
- No tax collection obligation on seller without a physical presence in a state (same!).
Polling Question #2
Your clients…
The Use Tax

• Complimentary to Sales Tax
• Paid by the Purchaser Directly
• Protects In-State Companies
Example

• Susie, who resides in Texas, received a catalog from SunGlassesGalore and has selected a pair to order.
• She reviews the order form and notes in the fine print that “customers in CA, FL, and IL, must add sales tax.”
• Susie happily sends in her order form and feels like she has saved the sales tax.
# Uncollected Use Tax

<table>
<thead>
<tr>
<th>Top Five States In Revenue Loss</th>
<th>Est. 2012 Uncollected Sales Tax (in Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>$4,159</td>
</tr>
<tr>
<td>Texas</td>
<td>$1,777</td>
</tr>
<tr>
<td>New York</td>
<td>$1,767</td>
</tr>
<tr>
<td>Florida</td>
<td>$1,483</td>
</tr>
<tr>
<td>Illinois</td>
<td>$1,058</td>
</tr>
</tbody>
</table>
The “Amazon Dilemma”

- Large vs. small companies
- “Tax loopholes”
- Compliance burden
- Use tax
State “Amazon Laws”

Amazon laws with “click-through” nexus provisions are aimed at retailers who contract with in-state marketing affiliates.
State “Amazon Laws” – Definitions

“Click Through” Nexus: in-state marketing affiliates create physical presence

“Marketing Affiliate”: related (or unrelated) companies that post web links; banners, etc. that refer back to the online stores of large retailers.
State “Amazon Laws” – Definitions

“Affiliate Nexus”: a related company (i.e., ownership) operating in a state can create in-state presence for the remote seller
State “Amazon Laws”

Nuances

Usually a dollar threshold of sales volume must be exceeded. (Generally low)

Can sometimes rebut the nexus presumption, but it is difficult in reality.
State “Amazon Laws”
More Nuances

The affiliate that “creates nexus” for the retailer does not collect & remit tax. The retailer is responsible for collecting and remitting the sale tax.

The “affiliate” pays its own taxes (corporate, personal, etc.) on net income, including commission.
State “Amazon Laws”
Picture this…

SunGlasses Galore:
• Based in TX
• Want to sell in CA
• Contracts with me in CA for a banner ad.

Miles Consulting:
• Based in CA
• Link to SG
• Help generate $100K of sales
• Earn 1% Commission
State “Amazon Laws”

Picture this…

SunGlasses Galore:
- Has exceeded the CA $10K threshold and must collect & remit sales tax

Miles Consulting:
- Does not collect tax on the sunglass sales
- Will report income of $1,000 in commissions in CA
States Where Amazon Collects Sales Taxes
(as of May 2014)

- **Blue**: Affiliate Nexus Law adopted & Amazon collects sales tax
- **Light Blue**: Affiliate Nexus Law adopted & Amazon does not collect (No in-state sales affiliates or law not in effect yet)
- **Green**: Amazon has a physical presence & collects sales tax
- **Light Green**: Amazon has a physical presence & will collect sales tax beginning in 2016
- **White**: State has no sales tax

*In Pennsylvania, Kansas, and Connecticut, Amazon also has a physical presence. For more about these policies and details on each state, visit the Internet Sales Tax Fairness page at www.ilsr.org.*
States with Amazon Laws “Early Adopters”

<table>
<thead>
<tr>
<th>State</th>
<th>Year Enacted</th>
<th>$ Threshold (Annual)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>2008</td>
<td>$10,000</td>
</tr>
<tr>
<td>North Carolina</td>
<td>2009</td>
<td>$10,000</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>2009</td>
<td>$5,000</td>
</tr>
<tr>
<td>Colorado*</td>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>Illinois</td>
<td>2010</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

* CO – Notification & Reporting - Challenged
States with Amazon Laws 2011

<table>
<thead>
<tr>
<th>State</th>
<th>Year Enacted</th>
<th>$ Threshold (Annual)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arkansas</td>
<td>2011</td>
<td>$10,000</td>
</tr>
<tr>
<td>Connecticut</td>
<td>2011</td>
<td>$2,000</td>
</tr>
<tr>
<td>Illinois</td>
<td>2011</td>
<td>$10,000</td>
</tr>
<tr>
<td>Vermont</td>
<td>2011</td>
<td>$10,000</td>
</tr>
</tbody>
</table>
States with Amazon Laws 2012 & 2013

<table>
<thead>
<tr>
<th>State</th>
<th>Year Enacted</th>
<th>$ Threshold (Annual)</th>
</tr>
</thead>
<tbody>
<tr>
<td>California*</td>
<td>2012</td>
<td>$10,000</td>
</tr>
<tr>
<td>Georgia</td>
<td>2012</td>
<td>$50,000</td>
</tr>
<tr>
<td>Pennsylvania**</td>
<td>2012</td>
<td>none</td>
</tr>
<tr>
<td>Kansas</td>
<td>2013</td>
<td>$10,000</td>
</tr>
<tr>
<td>Maine</td>
<td>2013</td>
<td>$10,000</td>
</tr>
<tr>
<td>Minnesota</td>
<td>2013</td>
<td>$10,000</td>
</tr>
<tr>
<td>Missouri</td>
<td>2013</td>
<td>$10,000</td>
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* CA – Originally enacted in 2011, effective 2012
** PA – No enacted statute, but PA issued Sales Tax Bulletin
Polling Question #3
Nexus: Why Is It Important?

- Sales tax is a gross tax. Net operating losses will not reduce a sales/use tax liability.
- Taxes based on capital stock may also apply.
- An aggressive state may assert that tax is due when in fact nexus has not been established.
- Sales tax is a pass through tax. The thing that concerns most companies is the burden and cost of collection and remittance of the taxes.”
Collecting & Remitting = Compliance

Compliance 101

- Nexus? ✓
- Rate? ✓
- Exemptions? ✓
- Registration ✓
- Forms - Electronic vs. Paper ✓
- Due Dates (vary) ✓
Why CPAs Should Care

• Audits
• Executive exposure
• Has your client collected and not remitted?
• Companies looking for acquisition (due diligence)
Audits

• Come when you least expect them
• Recommend assistance (don’t DIY)
• Some notices are fishing expeditions
• Aggressive auditors
Executive Exposure

• Personal liability
• Financial statement disclosure/implications
• No surprises!
A Few “OOPS”!

• Oops #1: Not filing where we need to
• Oops #2: Unclear on possible exemptions
• Oops #3: Improper documentation
• Oops #4: Collected sales tax and not remitted
Remedies

• Perform a nexus review
• Determine taxability of products/services
• Quantify risk and exposure
  – “XYZ” letters
  – Validity of exemption certificates
• Implement a plan to correct deficiencies
  – VDA
  – Amnesty
Voluntary Disclosure

• Most states allow companies to enter into voluntary disclosure agreements ("VDAs")
• The advantages include a reduced look-back period, abatement of penalties and ease of getting into the state’s system.
• Must use a 3rd party
Amnesty Programs

- States offer limited penalty (and sometimes interest) abatement
- Limited scope; limited applicability
- Use caution
- Consider other taxes
Thinking about Acquisition?

Due diligence

- Sales tax is often an exposure area
- Could hamper a deal
Possible Exposure Example

$10-million software company, HQ in CA, selling into multiple states:

\[
\begin{align*}
&$10,000,0000 \times 3 \text{ years} \times 50\% \text{ outside CA} \\
&= $30,000,000 \\
&\times 50\% \text{ through resellers} \\
&= $15,000,000 \text{ – sales w/possible exposure} \\
&\times 8\% \text{ average sales tax rate} \\
&= $7,500,000 \\
&\times \text{8\% average sales tax rate} \\
&= $600,000 \text{ – possible exposure}
\end{align*}
\]
M & A Considerations

• Due diligence – review sales and use on either side of the deal
• Nexus/taxability review
• Remedy the situation before the deal
• Ideally review within 1 year of acquisition
Practical Gems

• Have documentation for all significant transactions.
• Evaluate your nexus situation regularly to determine possible exposure - particularly if your company’s plans include merger/acquisition.
• States are reaching further, changing rules - keep up with changes in your industry.
Stretch Break?
Life in the Cloud

• The eroding tax base
• We’ve gone digital (music, software, gaming, SaaS)
In the Cloud

Characteristics:

- SAAS: Typically available via browser
- Typically sold on demand; purchaser can use as much or as little.
- Fully managed by the provider
- Generally billed based on usage vs. license fee
- No single definition for cloud computing
In the Cloud

State taxability positions vary:

• Not an enumerated taxable service
• Not a sale of software (TPP) because no transfer
• Not taxable because server is not in-state
• Taxable information, communication, or data processing service
• Taxable sale of software
In the Cloud

SaaS - Issues with Sourcing of Revenue (Sales Tax & Income Tax)

- Bill To Address?
- Ship To Address?
- Where benefit is received?
Streamlined Sales Tax Project

• SSTP, conceived in 2000 out of the desire to make the widely disparate state and local sales and use tax compliance requirements more uniform and predictable.

• Conforming states have enacted laws which bring their sales tax systems into conformity
Streamlined Sales Tax State Members
As of December 4, 2013

Notes: A full member state is a state that is in compliance with the Streamlined Sales and Use Tax Agreement through its laws, rules, regulations, and policies.

An associate state is a state that has achieved substantial compliance with the terms of the Agreement taken as a whole, but not necessarily each provision, measured qualitatively.

Source: The Streamlined Sales Tax Governing Board

taxfoundation.org/maps
SSTP - Aspects

1. Uniform definitions within tax law
2. Rate simplification
3. State-level administration
4. Registration
5. Uniform audit procedure
6. Technology models for remittance
SSTP Participants

• Proponents are proud that 28% of the country’s population now lives in a streamlined state
• …But 72% of the population does not!
SSTP Concerns

1. Although Enacted in 2005, SSTP Compliance Still Voluntary
2. Two Distinct Sales/Use Systems Running Parallel
3. Impacts on Middle Market Businesses
4. Limited Taxpayer Education
5. SSTP Does Not Address Other Taxes
Polling Question # 4
Familiar with SSTP? …
Federal Activity
Federal Activity

**Marketplace Fairness Act of 2015**

History:
- Since 2010, several bills have been introduced
- The MFA of 2013 passed by the US Senate (May 2013)
- Stalled in US House of Reps. and never passed.
- Essentially reintroduced as MFA 2015
Federal Activity

*Marketplace Fairness Act of 2015*

Requirements:
- Simplification
- Software
- Small seller exception
- Effective date?
Federal Activity

Online Sales Simplification Act of 2015. (Goodlatte)

• Origin-based sales tax collection
• Federal clearinghouse to re-distribute funds
Federal Activity

Remote Transactions Parity Act of 2015

Same as MFA 2015?

What’s new:

• Require enacting various new legislation
• Small seller exception
• Certified Service Provider and remote seller audits
Magic carpet, crystal ball…?

Can any of these pass?
Polling Question # 5
Thoughts on MFA? …
Collecting & Remitting = Compliance

Compliance 101

• Nexus?
• Rate?
• Exemptions?
• Registration
• Forms - electronic vs. paper
• Due dates (vary)
Collecting & Remitting = Compliance

Compliance 201

- Exempt items
- Gi-Go?
- Front-end due diligence
- Determine the right software
Some Final Thoughts…
How Can Miles Consulting Help You Provide Client Value?

- Perform Nexus Reviews
- Perform Taxability Studies
- Determine Appropriate Exemptions
- Recommend Compliance Model/Software
Why Do You Need SALT Services?

Examples of Projects that Your Current Clients May Need:

• Nexus Review
• Taxability Review
  – Unique Products
  – SaaS and other Technology
• M&A Transactions
  – Due Diligence
Some Final Thoughts…

Miles Consulting is a resource for CPAs:

- Monthly newsletter
- Weekly topical blog
- ½ hour complimentary consultation for any client (mention webinar)
Sign up for our newsletter & Preview our State Tax Checklist Here

http://www.milesconsultinggroup.com/CPA-checklist-signup.html
In Summary

It’s a crazy, interesting time

- States are aggressively pursuing revenue
- Congress is getting involved
- Technology companies have interesting issues (and usually need help)
- Hire a professional
Questions?
Thank You!

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About the Sponsor

Avalara is a team of developers, accountants, support specialists, marketers, salespeople, researchers, and technologists who know we’re on to something big.

We know we are part of a team that is revolutionizing what is a huge drain for businesses of all sizes: managing the compliance of transactional taxes, from sales and use tax to 1099s and more.