

Wayfair: The Far-Reaching Effects of Killing Quill

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In this viewpoint, Roberts examines some of the ways that *Wayfair* may affect state tax planning based on a physical presence requirement.

Wayfair: Elimination of the Physical Presence Nexus Standard

In its ruling in *South Dakota v. Wayfair Inc.*,¹ the U.S. Supreme Court issued a relatively narrow sales and use tax decision confirming that the physical presence test from *Quill v. North Dakota*² was no longer applicable. Under *Quill* and its predecessor,³ for more than 50 years states had been prohibited from forcing an out-of-state seller to collect a state's use tax unless the seller had a physical presence in the taxing state — because otherwise the seller lacked “substantial nexus” with the state. The *Wayfair* Court expressly overruled *Quill*; it evaluated South Dakota's statutory sales and use tax collection statute and ruled that if an out-of-state seller met the statutory threshold by having sales of more than \$100,000 to South Dakota customers, or at least 200 transactions with South Dakota customers, the seller with no physical presence nonetheless had substantial

nexus with South Dakota for purposes of enforcing use tax collection under the commerce clause.⁴

The Supreme Court did not uphold South Dakota's law in full or provide additional guidance, but instead remanded the case for further factual development regarding whether the statute satisfied the other constitutional requirements under the commerce clause and *Complete Auto Transit*.⁵ However, regardless of remaining remand issues or procedural matters, the Supreme Court's decision eliminated the long-standing physical presence test that has served as a foundation for nexus determinations applicable to many state tax structures throughout the United States.

What Does Wayfair Mean for Multistate Sellers Regarding Sales and Use Tax?

As a threshold issue, *Wayfair* means that state tax planning based on a physical presence requirement is no longer reliable. This is true for *Wayfair*-style economic nexus provisions, and potentially for previously existing laws, including affiliate and click-through nexus statutes. And while affiliate and click-through nexus statutes were generally supported by the analysis in *Wayfair*, such provisions are distinct from the pure economic nexus provision addressed by the *Wayfair* Court.

¹ 585 U.S. ___ (2018).

² 504 U.S. 298 (1992).

³ *National Bellas Hess Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967).

⁴ This level of business activity was held to satisfy the substantial nexus test resulting from *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977).

⁵ *See Id.*

Table 1. Sample Sales and Use Tax Economic Nexus Provisions

State	Economic Nexus Provision	Effective Date	Annual Transaction Threshold	Annual In-State Sales Threshold
Alabama	Ala. Admin. Code r. 810-6-2-.90.03; Ala. DOR Release (July 3, 2018)	Oct. 1, 2018 (originally Jan. 1, 2016)	N/A	\$250,000
Connecticut	Conn. Gen. Stat. sections 12-407(12) and (15) as amended by P.A. 18-152 (S.B. 417)	Dec. 1, 2018	200	\$250,000
Georgia	Ga. Code Ann. section 48-8-30 (c.2)(1)(A)	Jan. 1, 2019	200	\$250,000
Hawaii	Haw. Rev. Stat. section 237 as enacted by 2018 Haw. Laws Act 41 (S.B. 2514); Haw. Department of Taxation Announcement No. 2018-10 (July 10, 18)	July 1, 2018	200	\$100,000
Illinois	35 Ill. Comp. Stat. 105/2	Oct. 1, 2018	200	\$100,000
Indiana	Ind. Code section 6-2.5-2-1	Oct. 1, 2018 (pending litigation)	200	\$100,000
Iowa	Iowa Code section 423.14A	Jan. 1, 2019	200	\$100,000
Kentucky	Ky. Rev. Stat. Ann. section 139.340	July 1, 2018	200	\$100,000
Louisiana	La. Rev. Stat. sections 47:301(4)(m) and 47:302(W)(6) as enacted by 2018 2nd Ex. Sess. Act 5 (H.B. 17)	Contingent on <i>Wayfair</i> ruling (likely Jan. 1, 2019)	200	\$100,000
Maine	Me. Rev. Stat. Ann. tit. 36, section 1951-B	Oct. 1, 2017	200	\$100,000
Massachusetts	830 Mass. Code Regs. 64H.1.7; Mass. DOR Release (June 22, 2018)	Jan. 1, 2018	100	\$500,000
Michigan	Michigan Revenue Administrative Bulletin 2018-16	Oct. 1, 2018	200	\$100,000
Minnesota	Minn. DOR Notice & FAQ	Oct. 1, 2018	100	\$100,000
Mississippi	Miss. Code Ann. section 35-IV-03.09; Miss. DOR Release (June 21, 2018)	Dec. 1, 2017	None	\$250,000
North Dakota	N.D. Cent. Code section 57-39.2-02.2.; North Dakota Tax Commissioner Press Statement (July 11, 2018)	Oct. 1, 2018	200	\$100,000
Ohio	Ohio Rev. Code Ann. section 5741.01(I) (in-state software nexus); Information Release ST 2017-02 (Oct. 2017); Information Release ST 2001-01 (revised Oct. 2017)	Jan. 1, 2018 (pending litigation)	None	\$500,000

Table 1. Sample Sales and Use Tax Economic Nexus Provisions (Continued)

State	Economic Nexus Provision	Effective Date	Annual Transaction Threshold	Annual In-State Sales Threshold
Oklahoma	68 Okla. Stat. sections 1392, 1393, and 1394	July 1, 2018	None	\$10,000
Pennsylvania	72 Pa. Cons. Stat. sections 7213.1, 7213.2, 7213.3 (elective alternative to notice reporting only); Sales and Use Tax Bulletin 2018-01 (Jan. 26, 2018)	Apr. 1, 2018 (Apr. 1, 2019 alternative)	None	\$10,000
Rhode Island	R.I. Gen. Laws section 44-18.2-3 (elective alternative to notice reporting only); R.I. DOR Publication 2018-06 (July 20, 2018), R.I. DOR advisories ADV 2018-24 (June 27, 2018) and ADV 2018-29 (July 23, 2018)	Aug. 17, 2017 (July 31, 2018 alternative)	200	\$100,000
South Dakota	S.D. Codified Laws section 10-64-2; S.D. DOR Release (June 26, 2018)	May 1, 2016 (pending litigation)	200	\$100,000
Tennessee	Tenn. Comp. R. & Regs. 1320-05-01-.129	July 1, 2017 (pending litigation)	None	\$500,000
Utah	Utah Code Ann. section 59-12-107(2), to be modified by 2018 S.B. 2001 (signed by Gov. Gary Herbert July 21, 2018)	Jan. 1, 2019	200	\$100,000
Vermont	32 Vt. Stat. section Vt. Stat. Ann. Tit. 32, section 9701(9)); Vt. Department of Taxes statement (June 2018)	July 1, 2018	200	\$100,000
Washington	Wash. Rev. Code sections 82.08.053, 82.13.020 (elective alternative to notice reporting only); Wash. DOR Marketplace Fairness Ltr. (Oct. 2017)	Jan. 1, 2018	None	\$10,000
Wisconsin	Rules to be developed under authority of Wis. Stat. section 77.51(13g)(c) Wis. DOR Release (July 5, 2018)	Oct. 1, 2018	200	\$100,000
Wyoming	Wyo. Stat. Ann. section 39-15-501; Wyo. DOR notice (June 2018)	July 1, 2017 (litigation pending)	200	\$100,000

From a practical perspective, for multistate sellers that do not collect sales or use tax in all taxing jurisdictions,⁶ there may be exposure to multiple sales and use tax audits and assessments soon. To address these exposures, a comprehensive review is recommended to evaluate two primary factors: First, consider which states apply an economic nexus threshold for sales and use taxes; and second, consider which states are significant markets for the business at issue (for example, in which states does the business have sales of more than \$100,000, or have at least 200 transactions per year?). Table 1 is an example of how the recommended analysis would begin — by identifying states that use provisions like South Dakota’s nexus laws.⁷

For any business that has material sales to customers in those states,⁸ a strategy should be adopted to identify, quantify, and address the exposure created by any past⁹ or present failure to collect the applicable state sales or use tax. In many cases, strategies that rely on the physical presence test as a protection will need to be reevaluated and changed very quickly. Those strategies in many cases will include consideration of state-specific and Multistate Tax Commission voluntary disclosure agreement (VDA) programs. In this context, each case presents distinct issues, and a complete evaluation is recommended before any actions are taken regarding a specific VDA program. However, if a VDA program is available, a taxpayer generally may become compliant while limiting exposure to penalties, interest, and taxes regarding prior-year tax compliance matters.

⁶ Forty-five states, the District of Columbia, and more than 10,000 local jurisdictions impose sales and use taxes in the United States.

⁷ State approaches to nexus vary, and states may use legislative, regulatory, or administrative provisions to attempt to implement nexus policies. This area of the law is dynamic and rapidly developing. Therefore, the table in this article is included for illustrative and didactic purposes, and updated research is required for state-specific questions and fact situations.

⁸ And potentially other states that attempt to adopt economic nexus through existing laws or administrative guidance.

⁹ From a practical perspective, in most cases the exposure should be limited to sales activity beginning on or after the date of the *Wayfair* decision because the best approach for states would be prospective application. However, not all states have enacted provisions or announced their plans regarding how *Wayfair* will be applied, or when the effective date of a specific provision might be.

Wayfair and Its Impacts Beyond Sales and Use Taxes: Income/Business Taxes and Financial Reporting

Although *Wayfair* is a relatively narrow decision, its impacts on business are far-reaching and significant. That is because several areas regarding — but separate from — sales and use tax effectively adopted the physical presence test as a foundational premise. Those include state income/business taxes and financial reporting requirements.

Wayfair and Income/Business Tax Nexus Determinations

There is a division among states regarding the appropriate nexus standard to apply to state corporate income or business taxes (collectively “income tax” or “income taxes”). Many states have adopted income tax laws that assume a state cannot impose a corporate or business income tax on an out-of-state business that has no physical presence in the state. Those states have relied on the *Quill* physical presence test as a threshold in making income tax nexus determinations. Only a select group of states have departed from the *Quill* physical presence test and adopted an economic presence standard for income taxes.

Consistent with the widely accepted historical view that a physical presence approach has application to state taxes generally, many businesses that do not have physical presence in particular states have not reported state income tax liabilities in those states. The concern is that some of these states have adopted economic presence nexus standards in their income tax structures. Now that *Wayfair* has eliminated the physical presence test, it is likely that two issues will emerge: (1) states that have economic presence nexus standards for income taxes will aggressively pursue nonfilers; and (2) states that previously relied on the physical presence test will join the economic nexus states, abandon physical presence nexus laws, and adopt economic nexus provisions for their income taxes.

For businesses that have not filed income tax returns in states with economic nexus standards, there can be material exposure. The appropriate strategy for these businesses is to

act quickly and evaluate both the states that have economic nexus standards and the sales that are made to customers in those states. This analysis also will require each business to evaluate whether, in states that impose an income tax, the business activities at issue are protected by P.L. 86-272 (for example, the activities are protected because they are limited to “mere solicitation” of sales of tangible personal property). In general, P.L. 86-272 does not protect business activities that generate service or intangible income. If, based on a preliminary review, there is exposure, the next steps would be to quantify the tax exposure and consider whether a VDA is appropriate to minimize penalties and, if possible, the number of past years’ tax returns that need to be filed. Table 2 is intended to illustrate how the recommended analysis would begin by identifying states that have enacted economic nexus standards for income taxes.¹⁰

Like the situation in the sales and use tax area, state approaches to income tax nexus determinations and lookback periods vary; therefore, potential exposure in each state should be analyzed individually.

Financial Reporting Considerations

Wayfair has created “new” financial reporting concerns regarding both sales and use tax and state income tax. Those concerns are separate, but related, and arise as a direct result of the elimination of the *Quill* physical presence test. Without the physical presence test as “protection” from state tax authorities, businesses are expecting increasing tax liabilities, and financial accountants are required to disclose those expectations as liabilities in financial statements based on generally accepted accounting principles.

Table 2. Sample Income/Business Tax Economic Nexus Provisions

State	Economic Nexus Provision	Estimated Effective Date
Alabama	Ala. Code section 40-18-31.2(a)(2) & (b)	Tax years beginning after Dec. 31, 2014
California	Cal. Rev. & Tax. Code section 23101	Tax Years beginning on or after Jan. 1, 2011
Colorado	Colo. Code Regs. section 39-22-301.1	Apr. 30, 2010
Connecticut	Conn. Gen. Stat. section 12-216a	Tax years beginning on or after Jan. 1, 2010
Michigan	MCL 206.621(1)	Jan. 1, 2012
Minnesota	Minn. Stat. section 290.015	Pre-2012
New York	N.Y. Tax Law section 209(1)	Tax years beginning on or after Jan. 1, 2015
Ohio	Ohio Rev. Code Ann. section 5751.01	July 1, 2005
Tennessee	Tenn. Code Ann. section 67-4-2007; 67-2004(49)(A)	Tax years beginning on or after Jan. 1, 2016
Virginia	Va. Code Ann. section 58.1-400	Pre-2014
Washington	Wash. Rev. Code section 87.04.067(1)	June 1, 2010 (wholesale); July 1, 2017 (retail)
Wisconsin	Wis. Stat. section 71.23; Wis. Admin. Code Tax section 2.82	Pre-2012

¹⁰ This table also includes state taxes that may not be pure “income taxes,” such as a franchise tax. These nuances may create additional considerations, but a discussion of the differences among income, franchise, and other business taxes is beyond the scope of this article.

Regarding sales and use tax, Accounting Standards Codification (ASC)¹¹ 450 generally requires that a liability for these types of “indirect taxes” must be accrued if the liability is probable of assertion and can be determined with reasonable accuracy. For many businesses, there will be exposure to current and future sales and use tax liabilities in a variety of states, which may increase accruals. However, although there is little certainty at this point, concerns over accrued liabilities for sales and use taxes from prior years may be low because early indications are that states are likely to apply any South Dakota-style economic nexus provisions prospectively (for example, see the effective dates include in the table above).

Regarding state income taxes, ASC 740 generally requires that an income tax liability be accrued using standards like those applied under ASC 450. In states that used economic nexus standards for income taxes before the *Wayfair* decision, therefore, businesses may face exposure to prior-year income tax liabilities — as such prior-year liabilities now are both probable of assertion and determinable with reasonable accuracy. For example, Table 2 above shows that several states enacted economic nexus provisions many years ago; therefore, businesses that did not file income tax returns in those states because of reliance solely on the *Quill* physical presence test may face liabilities for tax, penalties, and interest for all years in which economic nexus existed and returns were not filed. For financial reporting purposes, in these instances the liabilities at issue must be accrued. This exposure has been documented in at least one recent instance in which a large company reported this type of accrued liability,¹² and it is anticipated that many companies will act similarly and will be reporting increased state income tax liabilities associated with *Wayfair*.

Conclusion

Although the decision in *Wayfair* itself presents a relatively narrow ruling, it may be the most significant state tax decision in recent history. This significance is reflected in the wide range of publications and professional and business discussions of *Wayfair* and its far-reaching effects on both large and small businesses across the country. These effects can create unexpected and unprecedented exposures for both remote sellers and more traditional businesses. The key conclusion in many cases is the following: Any business that structured its operations or engaged in tax planning based on the long-standing, 50-year-old physical presence test from *Quill* and *National Bellas Hess* is well advised to review not only its multistate sales and use tax issues, but also its state income tax and financial reporting obligations regarding potential *Wayfair* implications. ■

¹¹The Accounting Standards Codification of the Financial Accounting Standards Board is the source of authoritative GAAP.

¹²See, e.g., Michael Rapoport, “Wells Fargo’s \$481 Million Tax Surprise,” *The Wall Street Journal*, July 13, 2018 (Wells Fargo release regarding an increased state income tax liability accrual of \$481 million because of the recent *Wayfair* decision).