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5 STEPS TO STATE SALES/ USE TAX COMPLIANCE IN THE WAKE OF WAYFAIR

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On June 21, the U.S. Supreme Court issued its widely anticipated decision in *Wayfair*. The Court held that states may require businesses to collect and remit sales and use taxes even if the business has no in-state physical presence.

The *Wayfair* decision means that states are now free to subject companies to state taxes based on an "economic" presence within their state. Overnight, remote sellers, licensors of software, and other businesses that provide services or deliver their products to customers from a remote location must now start complying with state and local taxes.

Left unchecked, these state and local tax obligations, and the corresponding potential liability from tax, interest and penalties, will grow over time. Moreover, neglecting your sales and use tax obligations may result in a lost opportunity to pass the sales and use tax burden to customers as intended by state tax laws. Review these 5 steps to address state sales/use tax compliance

STEP 1: Determine Nexus and Filing Obligations

Over 20 states have enacted economic presence nexus statutes for sales and use tax purposes and nine states have enacted economic "factor presence" statutes for income tax purposes. The number of states that adopt economic nexus statutes is expected to grow in the months to come.

In many states, $100,000 or more in sales, or 200 or more transactions on an annual basis results in economic nexus and a filing obligation.

Since U.S. tax treaties apply at the federal level but not the state level, foreign businesses selling into the U.S. will also be subject to states' economic nexus statutes and sales/use tax collection and compliance requirements.

STEP 2: Evaluate Product and Service Taxability

For sales and use tax purposes, companies need to know whether the products and services that they sell (and also purchases they make) are subject to sales and use tax in the states and localities where they have nexus.

STEP 3: Quantify Potential State Tax Exposure

In states where nexus and tax exposure exists for prior periods, companies should quantify the historical sales and use tax and state income tax exposures using historical sales and income data and totals by state and by product. For some companies, the state tax exposure amount may need to be recorded as a liability for financial reporting purposes.

STEP 4: Mitigate and Disclose Historical Tax Liabilities

The exposure estimates should then be used to determine appropriate efforts to mitigate and disclose taxes. The course of action may differ for each state, and may include:

- **Sales/Use Tax Mitigation**: Historical tax liability estimates are generally calculated before favorable adjustments associated with exemption and other documentation are obtained from customers. Customers generally have an obligation to pay use tax directly to a taxing authority if the vendor does not collect the tax. Documentation from customers (e.g. exemption certificates, proof of use tax payment, proof of payment through audit), may significantly reduce the sales and use tax liability that you ultimately owe the state.
- **Voluntary Disclosure or Amnesty Programs**: Pursuing a Voluntary Disclosure Agreement (VDA) or participating in Amnesty programs (if available) with taxing authorities can significantly reduce the tax, penalties, and interest ultimately paid to resolve historical tax liabilities. VDAs and Amnesty programs can also streamline registration, tax filings, and payment of the historical tax liabilities.

STEP 5: Improve Processes in Preparation for Future Compliance Obligations

Once the business has determined in which states it has nexus and which of its products and services are subject to sales and use tax, as well as resolved any potential historical tax liabilities, it may need process improvement or ongoing assistance with prospective sales/use tax and state income tax compliance obligations. Through the use of advanced technology, businesses and tax departments are able to shift their resources to value-added activities and strategic tax planning while minimizing their compliance costs. Indirect tax automation technology optimizes sales and use tax processes and reduces costs by increasing efficiencies with the introduction of enhanced processes and applications.

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