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Dear Clients and Friends,

The Supreme Court ruling on *South Dakota v. Wayfair, Inc.* has drastically changed sales tax compliance for most states. Previously, a taxpayer generally had to be physically present in a state to have nexus (substantial connection), which triggered a requirement to collect and remit sales tax within the state. *South Dakota v. Wayfair, Inc.* established economic nexus, which does not require that a business be physically present. Each state has created their own guidelines for what triggers economic nexus. The most stringent requirement among the states is \$100,000 in qualifying sales and 200 separate transactions. Thus, if an out-of-state business has more than \$100,000 in qualifying sales or 200 sales transactions to any one state, then there may be a sales tax filing requirement.

California, as of April 1st, 2019, has a higher minimum. An out-of-state business will have a sales tax filing requirement if more than \$500,000 of qualifying sales are generated in California in the preceding or current calendar year.

This letter will focus on California's sales tax changes as a result of the *South Dakota v. Wayfair, Inc.* ruling. It will also discuss other important sales tax compliance issues that retailers should be aware of if they are conducting business in California.

South Dakota v. Wayfair, Inc.

South Dakota v. Wayfair, Inc. overruled the precedent set in *Quill Corporation v. North Dakota*, which held that The Commerce Clause barred a state from requiring out-of-state businesses to collect and remit sales tax if the business did not have a physical presence in the state. The June 2018 ruling of *South Dakota v. Wayfair, Inc.* allows economic nexus, which is a substantial connection with a state through economic means. The case ruled that an out-of-state retailer has economic nexus if more than \$100,000 of qualifying sales are made into the state or if the out-of-state retailer has 200 or more separate transactions for delivery of goods or services into the state.

California Assembly Bill 147

Following *South Dakota v. Wayfair, Inc.*, California passed Assembly Bill 147, which allows California to require out-of-state retailers to collect and remit sales tax on sales made to California customers, similar to South Dakota's new law. California's new law was effective on April 1, 2019. However, California requires out-of-state retailers to adhere to California's sales tax requirement only if retailers have qualifying sales to California customers in excess of \$500,000 in the current or preceding calendar year. Unlike South Dakota and many other states, California does not have a threshold for the number of sales transactions into the state.

Assembly Bill 147 also establishes that beginning October 1st, 2019, marketplace facilitators are liable for collecting and remitting California sales tax on behalf of retailers, if they meet the new requirements for out-of-state retailers. The bill requires that the marketplace facilitator include all sales made on its own and made on behalf of other retailers in the state to be considered when determining if the marketplace facilitator is required to collect and remit sales tax for sales made in California.

California's district tax will also be affected by the passing of Assembly Bill 147. California allows cities and counties to impose district taxes, which increase the base sales tax rate charged to customers within that district. A business is required to collect district tax on sales made in districts where it is engaged in business. Generally, the location of the business determined what district tax was charged to customers. However, Assembly Bill 147 altered the meaning of "engaged in business" to match the definition used for out-of-state retailers. Beginning April 1st, 2019, a business is considered engaged in business in districts where qualifying sales are in excess of \$500,000. This change will complicate sales tax compliance for in-state and out-of-state businesses, as each business will need to track the amount of sales made to each district. If the \$500,000 threshold is met, then each business will also need to collect sales tax at the applicable rate for each district as well.

The ruling of *South Dakota v. Wayfair, Inc.* has complicated the filing requirements for out-of-state businesses in almost every state. Retailers that conduct business in multiple states will need to be aware of the sales tax regulations for each state and will need to track sales by state, and possibly by district within each state.

Definitions

The following are general sales tax compliance terms that retailers should be familiar with. These are California definitions and should not be assumed to be the same for all states*.

Qualifying Sale –

Retailers are required to adhere to California's sales tax filing requirements if out-of-state retailers have qualifying sales in excess of \$500,000 in California. A qualifying sale is defined as a "sale of tangible personal property for delivery in California" made by the

retailer and all persons related to the retailer (over 50% common ownership). Tangible personal property is generally defined as property that can be perceived by the senses, i.e., seen, weighed, felt, or touched (for simplicity, known as “products”).

*Be advised, some states define sales as all sales or services delivered into the state, including exempt nontaxable sales, and including digital or electronically transferred products or services. Because wholesale sellers could potentially be required to file in specific states, it is highly recommended that resale certificates be obtained for all customers with exempt nontaxable sales.

Marketplace Facilitator –

Many retailers contract with third parties, known as marketplace facilitators, to assist in promoting and fulfilling sales. Amazon, Ebay, and Etsy are examples of a marketplace facilitator, as they contract with retailers to facilitate the sale of the retailers’ goods.

District Tax –

California imposes a base sales tax rate, at which businesses are required to collect sales tax. District tax is an additional tax rate imposed by various cities and counties within the state. For example, a San Diego based company is required to collect California’s base rate and the rate imposed by the City of San Diego. If California’s base sales tax rate is 7.25% and the City of San Diego’s district tax is .5%, then the business is required to collect 7.75% of sales tax from its customers.

Types of Nexus

Nexus is a substantial connection between a retailer and a state. There are various types of nexus that may trigger sales tax filing requirements. California’s nexus types include: physical presence, affiliate nexus, click-through nexus, and economic nexus. Advertising in a state or using software on a customer’s computer can also trigger nexus. To ensure sales tax compliance, it is important that a business understand each state’s sales tax rules that it engages business in.

Physical Presence –

A business may be considered physically present in a state if it has salespeople in the state, attends an event in the state, or stores inventory in the state. Payroll or an office/warehouse typically create this type of nexus.

Affiliate Nexus –

A retailer may have nexus in states that its affiliated entities conduct business in. Affiliate nexus is created in California if any of the following apply:

- The out-of-state retailer is affiliated with a company in California and the two entities have an agreement whereby the California company directly or indirectly refers potential customers to the out-of-state retailer.
- The out-of-state retailer is affiliated with a company in California and the two entities have an agreement whereby the out-of-state retailer pays the California company a commission (or other consideration) for completed sales of tangible personal property.
- The California affiliate company directly or indirectly solicits California customers on behalf of the out-of-state retailer.

Click-Through Nexus –

If an out-of-state business contracts with an individual or business located in another state to directly or indirectly refer potential customers to the out-of-state business through a web link for a commission (or other consideration), then nexus can be triggered.

Economic Nexus –

Since the ruling in *South Dakota v. Wayfair, Inc.*, many states have adopted economic nexus, which claims that a substantial connection can be created through economic activity.

Trailing Nexus –

If a business has established nexus in a state, that nexus may linger on after the business has ceased doing business in the state. Each state's rules are different, so it's important to know whether or not a state has trailing nexus, and how long the trailing nexus exists.

California, for example, requires that retailers that are no longer engaged in business in California must continue to collect and remit sales tax to California for the remainder of the quarter that the retailer ceased business operations in California and for the following quarter.

Delivery & Distribution –

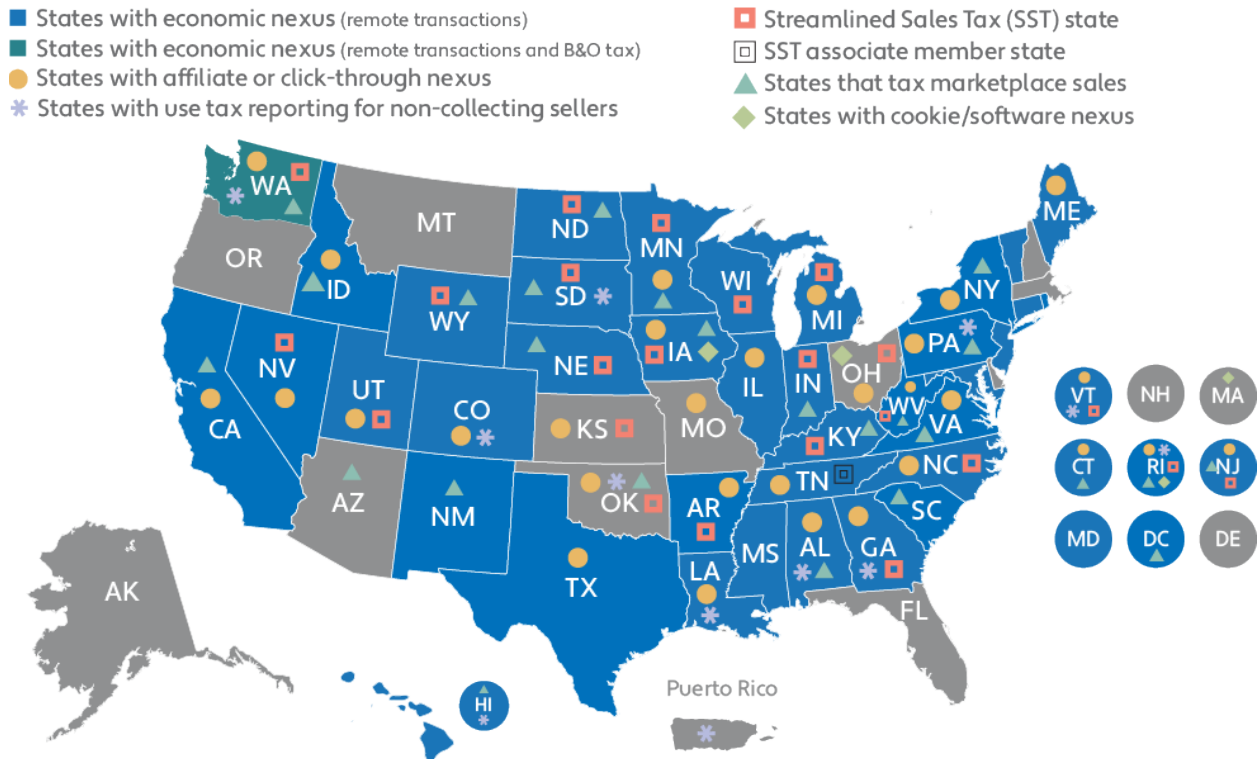
If products are delivered into a state personally or by using a company vehicle, then nexus can be triggered. Generally, if a common carrier is used to deliver products, then nexus will not be triggered.

Some retailers use drop shipping as a delivery method. The retailer does not possess the product inventory when this method is used. Instead, the retailer orders the products from a third party and has them shipped directly to the customer. Depending on the state,

sometimes the retailer will be liable for sales tax compliance. Other times, the third party used for drop shipping (drop shipper) is liable for sales tax compliance.

In California, the drop shipper is reclassified as the retailer and is required to collect and remit sales tax.

As of May 6, 2019, remote seller nexus by state is shown below –



Action Items

Identify your nexus. Track your sales. Set up a compliance structure. Get professional help.

Most retailers will be affected by the *South Dakota v. Wayfair, Inc.* ruling. To comply with the changes to state laws as a result of the ruling, retailers will need to analyze sales made to each state. The amount of sales, and possibly the number of sales transactions, made to each state will need to be tracked. As is the case with California, retailers may also need to track sales by each district within a state. This may require that retailers upgrade to software that can assist in tracking sales by state and district. Retailers should also seek the advice of sales tax experts to ensure compliance to the various state requirements.

We are available to assist with sales tax compliance by determining which states you are required to report in, as well as registering with these states. We can also help you find a sales tax software that monitors sales tax rates, connects with your in house accounting software to generate sales tax reports, and provide guidance on your sales tax filing requirements. This involves a customized in depth analysis to review your business, types of sales, range of customers, and potential nexus, to determine your state filing and reporting requirements.

Please contact us for further information.

Sincerely,

DUFFY KRUSPODIN, LLP