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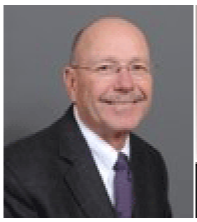
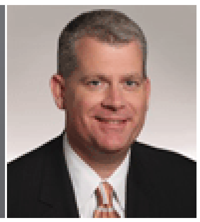
What Tax-Exempt Organizations Need to Know About *Wayfair*



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For 50 years before 2018, U.S. Supreme Court precedent held that a retailer needed more than a *de minimis* physical presence in a state before the state could compel it to collect and remit sales and use tax. That all changed on June 21 with the momentous *South Dakota v. Wayfair, Inc*. decision.

What Is *Wayfair?*

States that were frustrated with their inability to collect the bulk of use tax on online sales made by in-state purchasers, as well as their inability to impose a collection obligation on out-of-state sellers with no physical presence, began passing new types of laws and regulations in recent years, aimed at pegging sales tax nexus to economic -- not just physical -- presence. These rules were meant to challenge the constitutionality of the existing law, and it was South Dakota's rules that finally rose to docket of the U.S. Supreme Court.

The 5-4 decision in *Wayfair* allows South Dakota and every other state to now adopt an economic nexus standard, thereby compelling a seller without a physical presence in the state to nonetheless collect tax on sales to purchasers in the state. The Court did not hold that South Dakota's exact threshold of $100,000 of sales or 200 transactions with in-state customers is the standard that now applies in all states. As a result, each state's rules may look slightly different as they move to economic nexus for sales and use tax collection purposes. However, they all must follow the Supreme Court's directive to avoid discriminating or placing undue burden on interstate commerce.

There has been much discussion around whether imposing a sales/use tax collection obligation on a non-U.S. entity is an "undue burden." The authors believe it unlikely that state taxing authorities in jurisdictions that have adopted economic nexus thresholds will view it as unduly burdensome to impose a sales/use tax collection obligation on organizations that are operating in a state's market in amounts above the stated threshold. Thus, non-U.S. charities or tax-exempt organizations, as well as domestic entities, should be thinking about the implications of *Wayfair*. Note that international income tax treaties are not binding on states and localities for sales/use tax purposes.

How Are States Responding?

A number of states already have laws similar or substantially similar to South Dakota's, though some effective dates are still set in the future. There are others that currently have no economic nexus rules, but their "doing business" statutes may be broad enough to encompass remote selling.

States have begun issuing guidance and establishing dates by which they expect affected sellers to register and to begin collecting tax. Organizations will want to pay particular attention to states in which a "doing business" statute is sufficiently broad to encompass economic nexus but that have not yet announced the manner or date they intend to begin requiring collection.

It seems reasonable to expect that by mid-2019, nearly all states with a sales tax will have adopted an economic nexus standard. Organizations will need to carefully track each state's laws and regulations to stay compliant in the coming months and years as the *Wayfair* decision's effects reverberate.

Are Tax-Exempt Organizations Impacted?

Tax-exempt organizations must consider the implications of *Wayfair* from two perspectives -- selling and purchasing. Exemptions for purchases by tax-exempt organizations are common, but several states do provide exemptions for sales as well. The scope of those exemptions varies by state, and those rules have not been affected by *Wayfair*. Thus, the starting point for considering the impact of *Wayfair* is to clearly understand the exemptions currently afforded to charitable organizations in each state in which the organization operates. These exemptions have not changed as a result of *Wayfair*.

What has changed, however, is the situation facing tax-exempt organizations that engage in non-exempt sales or purchases. Tax-exempt organizations may confront changes from the *Wayfair* decision in several specific ways:

For one, nonprofits that sell in non-exempt circumstances into states with economic nexus standards -- and that meet the economic thresholds laid out in those standards -- will need to begin collecting and remitting sales tax on those taxable sales, just like businesses, regardless of whether they have a physical presence in the state.

Universities, publishers, and other educational organizations should be alert to rules governing online training and courses. There are multiple states that tax pre-recorded online educational content. If organizations sell a sufficiently large volume of this type of product (or other taxable products) into states with economic nexus, they may be required to collect and remit tax on those sales.

In addition, organizations should be aware that some states' economic nexus standards are tied to gross sales rather than taxable sales. This may result in registering and filing "zero returns" in certain states where the organization's in-state sales meet the economic nexus threshold, while maintaining documentation in the organization's files as to non-taxability.

The second, and more immediate, way the decision will affect organizations is with their purchases. Out-of-state sellers that have never charged sales tax in a given state before *Wayfair* may need to start collecting soon because they meet new economic nexus rules. Organizations should make sure their accounts payable department is aware that sales tax may start cropping up on invoices where it previously had not. Tax-exempt organizations will need to contact those sellers and give them a current exemption certificate (if applicable) to maintain tax-free purchasing.

To the extent the items purchased are destined for a state in which the tax-exempt organization is not currently registered for sales/use tax and would otherwise meet an exemption, the organization may need to register and obtain that state's exemption certificate. Merely showing the tax-exempt organization's IRS exempt status letter generally is not sufficient to document an exempt purchase or sale for state sales/use tax purposes.

Six Steps to Take to Cope with Wayfair

Tax-exempt organizations can and should plan, prepare, and carry out the following recommendations in order to deal with the implications of the Supreme Court decision.

1. Uncover the specific facts and figure out overall sales and use tax nexus footprint. Determine whether they have physical presence nexus (which has not gone away) or economic nexus under the new standards.

Next, organizations should follow these steps to ensure compliance:

2. Communicate with all stakeholders in the organization to ensure they understand the new sales tax landscape and are aware of coming changes. Involve legal, marketing, supply chain, technology, direct tax, accounts payable and finance.

3. Review the organization’s product/service mix, including developing taxability determinations and examining bundled transactions (which may include both taxable and exempt items).

4. Review technology needs and consider tax engine implementation, upgrades or outsourcing. The use of technology and automation is ideal for the complex process of determining which of the products they are selling may be taxable in each state, computing the appropriate amount of tax due on each transaction, updating regularly changing sales/use tax rates and preparing and filing the requisite tax returns and remittances

5. Register in new jurisdictions where required and ensure all returns and remittances are filed timely, and obtain and maintain applicable exemption certificates. Consider the income tax or other tax implications of registering with the state taxing authority

6. Stay abreast of all related tax updates and prepare for increased audit activity in new jurisdictions. Organizations will need to dedicate resources (either internal team members or outsourced assistance) to keep an eye on changing regulations and statutes across states.

Ultimately, the sales tax landscape is undergoing a monumental shift, and it’s important for tax-exempt organizations to prepare now so as not to be left behind.