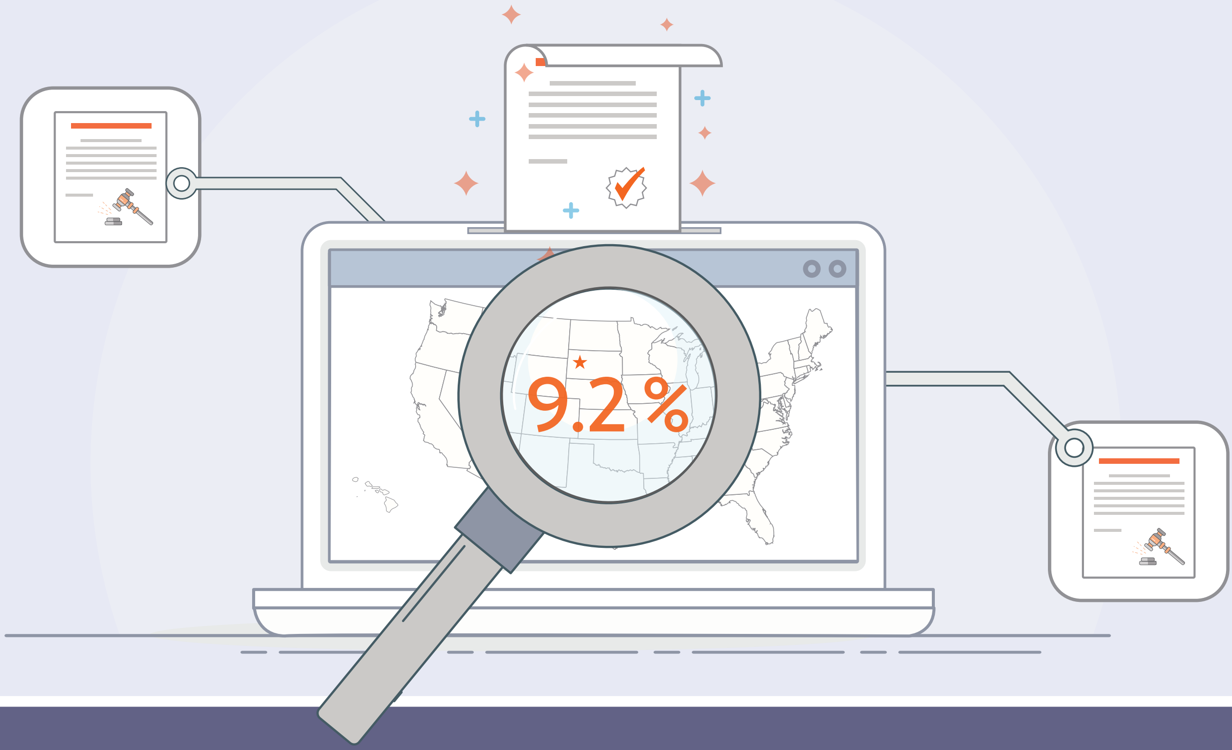


2019 sales tax changes

Avalara
Tax compliance done right

Whitepaper

Like its predecessor, 2019 will be a year of significant sales tax changes. Because the Supreme Court of the United States ruled in favor of the state in South Dakota v. Wayfair, Inc., states can now require remote sellers to collect and remit sales tax. More than 30 states and the District of Columbia have remote seller sales tax laws on the books as of December 2018. Expect more states to pursue economic nexus and/or other remote sales tax laws in the year ahead.

2019 is also likely to bring change for marketplace facilitators as states require them to shoulder more of the sales tax burden and collect tax on behalf of their third-party sellers. Even under expanded nexus provisions, many marketplace transactions currently go untaxed – states don't want to let another year go by leaving that revenue on the table.

While we can't say for certain what changes 2019 will bring, we can share burgeoning sales and use tax trends likely to impact sales tax compliance in 2019.

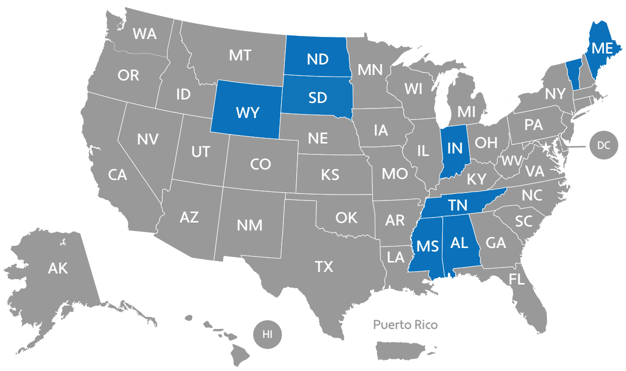
2018 recap: the end of the physical presence limitation

2018 was probably one of the biggest years for sales tax in the United States since the inception of sales tax: In South Dakota v. Wayfair, Inc. (June 2018), the U.S. Supreme Court overruled a physical presence rule that had long prevented states from taxing remote sales: States won the right to tax sales by businesses with no physical presence in the state. In the wake of the ruling, states scrambled to adopt policies allowing them to tax remote sales. In addition, there were thousands of changes to sales tax rates, rules, and regulations in all sales tax states.

Here's a look at 2018 by the numbers:

- 31 states and the District of Columbia adopt economic nexus, requiring out-of-state businesses with a certain amount of economic activity in the state to collect and remit sales tax
- 10 states impose sales tax collection obligations on marketplace providers and sellers
- 5 states establish use tax reporting requirements for non-collecting sellers
- 2 states adopt affiliate or click-through nexus laws for out-of-state sellers
- 8 states offer amnesty on back taxes, penalties, and interest

The trend to tax remote sales is certain to continue in 2019. There will also be the normal slew of rate, regulation, and product taxability changes.



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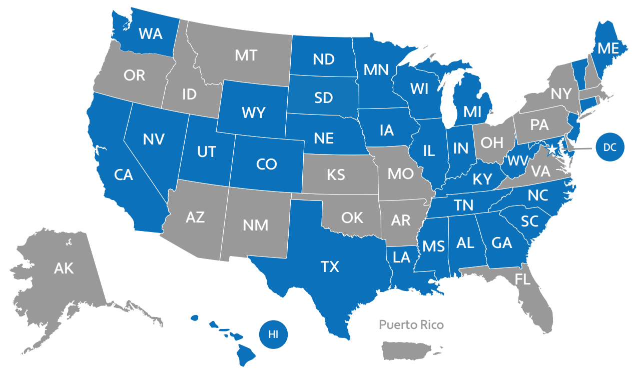


December 2018

Ecommerce and the fallout from South Dakota v. Wayfair, Inc.

According to Forrester Research, ecommerce sales are predicted to reach $500 billion for 2018. In the U.S. alone, retail sales jumped 200 percent between 2010 and 2017. States respond with new economic nexus laws – obligating remote sellers to file and remit sales tax based entirely on the volume of sales into a state.

Sales tax laws on remote sellers tripled after U.S. Supreme Court ruling in South Dakota v. Wayfair, Inc.

2019 sales tax headlines

It's no longer just about "location, location, location."

Joining the 21 states that started enforcing economic nexus in 2018, Georgia, Iowa, Nebraska, Utah, West Virginia, and Washington, D.C. will all enforce it starting January 1, 2019. Louisiana was set to do the same but pushed back the start to "a date to be determined in 2019." Wyoming will enforce economic nexus on February 1, 2019, as will California on April 1, 2019, and Texas on October 1, 2019. Once state legislatures convene in 2019, more states are likely to adopt economic nexus – including Tennessee, which has a law on the books but needs the Legislature's approval to enforce it.

The principle of economic nexus is the same in all states: Out-of-state businesses trigger a sales tax collection obligation through their economic activity in the state, either sales or transactions in the state, or both. Specifics differ from state to state, the devil being in the details.

What is economic nexus? Economic nexus is a sales tax collection obligation based solely on a company's economic activity within a state. Unlike sales tax nexus that's based on physical presence, economic nexus is based entirely on sales revenue, transaction volume, or a combination of both. Like many sales tax laws, economic nexus criteria vary by state.

Small seller exception. All states with economic nexus allow an exception for small out-of-state sellers. Many exempt remote sellers with less than $100,000 in sales or fewer than 200 transactions in the state in the current or previous calendar year. However, Alabama's small seller threshold is $250,000 in annual sales, and Georgia's is $250,000 in sales *or* 200 retail sales in the state in the current or previous calendar year.

The fine print. Small but significant differences between economic nexus laws are found elsewhere as well. Beginning January 1, 2019, a remote seller must register with the state and start collecting tax *the day after* it meets the threshold in West Virginia. Yet, while a seller must obtain an Iowa sales tax permit as soon as it exceeds the small seller exception, that seller has until the first day of the calendar month that starts at least 30 days from the day the threshold was exceeded to start collecting Iowa sales tax.

Most states with a general sales tax are likely to adopt economic nexus in 2019 if they haven't already done so. Economic nexus has already been introduced in Arkansas, Missouri, and Virginia. It's even under consideration in Alaska, which has no statewide sales tax but does allow jurisdictions to tax sales at the local level.

If not economic nexus, states will likely come up with another viable solution for increasing remote sales tax revenue.

Economic nexus alternatives

Though it may be the most likely to succeed, economic nexus isn't the only option available to states interested in taxing more remote sales. Some states are still turning to click-through and cookie (software) nexus; others are targeting marketplace sales; and some rely on use tax reporting requirements for non-collecting sellers to encourage voluntary compliance with sales and use tax laws.

For example, click-through nexus took effect in Idaho on July 1, 2018. Any out-of-state vendor that receives more than $10,000 in annual gross receipts from in-state referrals establishes click-through nexus and an obligation to collect and remit Idaho sales tax. More than 20 states have click-through nexus laws on the books.

Massachusetts, Ohio, and Rhode Island enforce cookie nexus. Shortly after the Supreme Court decision in South Dakota v. Wayfair, Inc., the Massachusetts Department of Revenue reiterated that the existing regulation compelling vendors making internet sales to collect and remit sales tax "continues to apply." The Ohio Department of Taxation announced that Ohio's sales tax laws "will stay the same until the General Assembly decides whether or not to change them."

As more states embrace economic nexus in 2019, we may see fewer new click-through and cookie nexus laws. The same probably can't be said for marketplace sales tax laws.

Online marketplace as sales tax collector

Online marketplaces are overtaking traditional department stores as the top revenue drivers in retail, offering one-stop shopping with a few clicks of the mouse. Half of all ecommerce spending in 2016 took place through online marketplaces, and that number is trending up: Worldwide, marketplace providers are expected to more than double their 2017 earnings by 2022, from $18.7 billion to $40.1 billion.

Yet many marketplace sales go untaxed. In December 2017, the U.S. Government Accountability Office (GAO) reported that states could substantially increase their sales tax revenue by taxing online marketplace sales. The GAO estimated that while 58–64 percent of non-marketplace online sales were taxed in 2017, only 14–33 percent of online marketplace transactions were subject to sales tax.

States didn't need to be told twice. Minnesota had already enacted a marketplace sales tax, with an effective date hinging on the repeal of the physical presence rule. Oklahoma, Pennsylvania, Rhode Island, and Washington quickly followed Minnesota's lead, passing marketplace sales tax legislation prior to the release of the GAO report.

As of December 1, 2018, Arizona, Connecticut, Minnesota, New Jersey, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Virginia, and Washington all enforce marketplace sales tax laws. They take effect in Washington, D.C. and three additional states in early 2019: Alabama, Iowa, and South Dakota. As 2019 progresses, marketplace sales tax laws are likely to morph and multiply. Some experts predict every state will require online marketplaces to collect sales taxes on behalf of their sellers by 2020.

Not everyone is certain that's a good idea. Craig Johnson, Executive Director of the Streamlined Sales Tax Governing Board (SST), worries these laws could lead to confusion over who's responsible for collecting and remitting sales tax, particularly for retailers that sell through multiple channels, including one or more marketplaces. And requiring marketplace facilitators to collect tax on behalf of their sellers won't necessarily simplify compliance for marketplace sellers. In Connecticut, for example, sellers must file returns and deduct sales made through marketplaces.

Use tax reporting – what is it? The idea behind use tax reporting requirements is simple: Force non-collecting retailers to either collect sales tax or provide states with information to facilitate use tax collection. States know most residents don't remit the use tax they owe, but they can't know who owes what without auditing everyone. However, it would be prohibitively expensive and time consuming for a state to audit every individual in the hopes of finding some with significant use tax liability. Enter non-collecting vendors who know who their customers are, where they live, and what they bought.

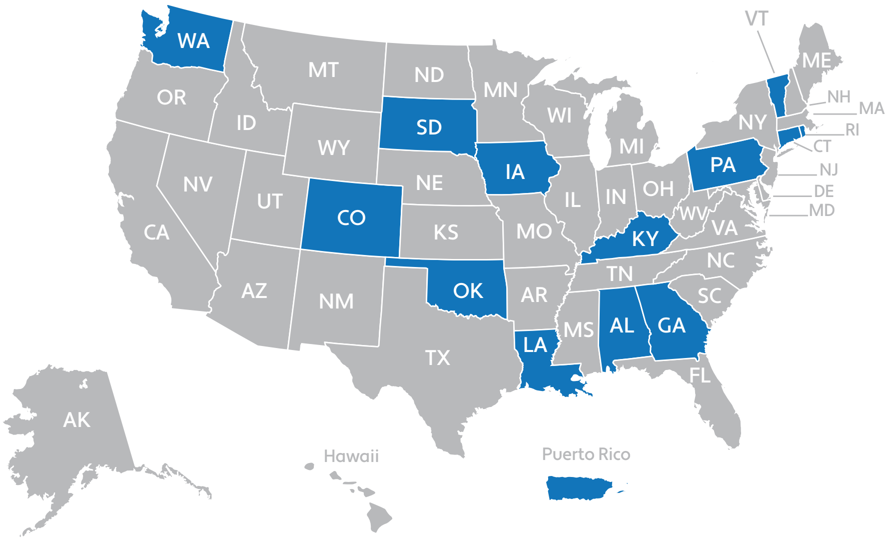
The end of non-collecting seller use tax reporting?

Restricted by the physical presence rule, some early adopters of marketplace sales tax laws encouraged voluntarily compliance by imposing use tax reporting requirements on non-collecting businesses, a trick they learned from Colorado. Until its economic nexus law took effect on December 1, 2018, non-collecting seller use tax notification and reporting requirements was Colorado's only tool to increase remote sales tax collection.

These laws require non-collecting sellers to notify consumers that they may owe use tax on their purchases because sales tax isn't being collected at the time of sale. In addition, non-collecting sellers must share customer information (e.g., descriptions and dollar amounts of purchases) with state taxing authorities. Marketplace facilitators must furnish the state with information about their third-party sellers.

The following states (and Puerto Rico) have adopted use tax notification and reporting requirements for non-collecting sellers:

- Alabama
- Colorado
- Connecticut
- Georgia
- Iowa
- Kentucky
- Louisiana
- Oklahoma
- Pennsylvania
- Puerto Rico
- Rhode Island
- South Dakota
- Vermont
- Washington



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Is use tax reporting still necessary? Now that the physical presence limitation has been repealed and states have the authority to tax remote sales, they may not need non-collecting seller use tax reporting. Nonetheless, those laws are still on the books in more than a dozen states and they can't simply be ignored. Businesses selling into these states may need to either collect or comply with the notification and reporting requirements.

The Tax Foundation counsels states to repeal their notice-and-reporting laws for non-collecting sellers.

NOMAD states fight back

With economic nexus, marketplace, and other remote sales tax laws on the rise, a small but insistent voice is protesting.

Five states don't have a general sales tax: New Hampshire, Oregon, Montana, Alaska, and Delaware (NOMAD). As more states look to tax remote sales, at least one NOMAD state is fighting back.

New Hampshire lawmakers are expressing outrage over the Supreme Court decision in South Dakota v. Wayfair, Inc. Governor Chris Sununu says anyone who tries to impose a sales tax collection obligation on New Hampshire businesses should prepare for "the fight of your life." Although the governor's first attempt to block other states from taxing New Hampshire businesses failed, the Legislature is expected to revisit this issue in 2019.

In the meantime, New Hampshire retailers that receive requests from other states relating to the collection of their sales tax are advised to notify their accountants and attorneys, as well as the New Hampshire Department of Justice. Although there's acknowledgment that New Hampshire businesses may be legally required to submit to such demands, the New Hampshire Division of Economic Development is concerned many such requests could be fraudulent.

It will be interesting to see how far New Hampshire gets with this. So far, it seems to be acting in isolation. Many localities in Alaska are looking at taxing remote sales in 2019, and the Montana Department of Revenue advises Montana businesses to collect and pay sales tax in other states as required by law. Delaware and Oregon haven't publicly commented on the ruling.

As states reshape the sales tax landscape, will Congress ever intervene?

New Hampshire may be the only state interested in fighting the Wayfair ruling, but there is dissent at the federal level. Some members of the United States Congress are intent on regulating or limiting the effects of South Dakota v. Wayfair, Inc. To that end, at least three bills were introduced in 2018, including:

Online Sales Simplicity and Small Business Relief Act of 2018 – **Protect small sellers**

The Online Sales Simplicity and Small Business Relief Act (H.R. 6824) seeks to protect small businesses from excessive regulatory burdens. It would prohibit states from taxing any remote sales made prior to the June 21, 2018, Wayfair ruling; and states would only be able to impose a sales tax collection obligation on remote sellers for sales occurring after January 1, 2019 (House version) or January 1, 2020 (Senate version). Additionally, it would prohibit the taxation of small remote sellers (i.e., sellers with gross annual sales in the U.S. of no more than $10 million) until the states and Congress approve an interstate sales and use tax compact.

Protecting Businesses from Burdensome Compliance Cost Act of 2018 – **Reduce compliance burdens**

Under the Protecting Businesses from Burdensome Compliance Cost Act (H.R. 6724), states interested in collecting remote sales tax would first have to enact legislation that establishes a statewide uniform tax rate not higher than the highest combined rate, allows out-of-state vendors to remit sales tax to one location, and provides statewide uniform taxability rules. The measure would prohibit states from retroactively taxing remote sales or from taxing any remote sales prior to January 1, 2019.

Stop Taxing Our Potential Act of 2018 – **Turn back the clock**

The Stop Taxing Our Potential Act (S. 3180) seeks to return the United States to the pre-Wayfair world. It would prevent states from imposing a sales tax collection obligation on any person that doesn't have a physical presence in the state during the tax period in question. The bill expressly prohibits affiliate and click-through nexus.

Will Congress act on one of these bills, or another? Many tax wonks think it unlikely. Congress had ample opportunity to deal with the issue of remote sales tax prior to the Supreme Court decision in Wayfair, and it didn't. Furthermore, states are prepared to fight to keep the right to tax remote sales. The National Governors Association has praised the Wayfair ruling, and the National Conference of State Legislatures has said it will "oppose any congressional effort seeking to delay, limit, or pre-empt state efforts to implement the Wayfair decision."

Everything else

The fallout from South Dakota v. Wayfair, Inc. took center stage during the second half of 2018, and it's likely to continue to grab the spotlight in 2019. Nonetheless, plenty of other sales and use tax changes are in the wings, including those listed on the pages that follow.

Hold remote sellers liable for other types of taxes

Now that the Supreme Court has overruled the physical presence rule, states may be able to require out-of-state businesses to comply with other tax laws in addition to sales tax. Indeed, the Texas Comptroller is currently updating franchise tax rules "to provide details about remote seller tax responsibilities" in the wake of the Wayfair ruling. Other states are likely to do the same with other taxes, including B&O tax and gross receipts tax.

Pay your taxes with bitcoin

Ohio became the first state to allow taxpayers to pay their sales, use, and other taxes with bitcoin in November 2018. It isn't the only state to consider accepting cryptocurrency tax payments. Legislatures in Arizona, Georgia, Illinois, New Hampshire, and Utah have all looked into allowing a cryptocurrency option for tax payments.

All eyes will be on Ohio to see what comes of this experiment. If it's a success, other states are likely to follow suit in 2019 and beyond.

Taxing sins

More than 21 states looked into legalizing adult-use marijuana in 2018, and that trend is likely to continue in 2019. It's now legal in 10 states and all of Canada – and where there's legalization, there are taxes. Pot has generated more than $700 million in tax revenue for Colorado since legalization in 2014. It generated $30 million for Nevada in just six months. The potential tax revenue is always part of the pro-legalization argument.

Meanwhile, some jurisdictions are looking at putting new taxes on more familiar products, such as alcohol. Pennsylvania will require manufacturers of malt and brewed beverages to tax their sales of craft brews starting July 1, 2019. Also in 2019, Anchorage, Alaska, will continue to discuss whether sales of alcoholic beverages should be taxed. Although Alaska doesn't have a statewide sales tax, many municipalities do levy a local sales tax. Anchorage isn't one of them, but it taxes sales of marijuana and the proposed tax on alcohol sales would be similar.

And a growing number of states, including California, Pennsylvania, and Washington, D.C., now tax e-cigarettes; other states could do the same in 2019. A bill under consideration in New Jersey would impose a 3.5 percent tax on the retail sale price of products containing liquid nicotine.

Taxing Netflix, etc.

The City of Chicago was one of the first places in the nation to tax streaming services such as Apple, Hulu, and Netflix. The 2015 tax affects a wide variety of streamed products, from games to movies to music. Inevitably, the so-called Netflix tax has triggered numerous lawsuits. To date, courts have found in favor of the city, and some companies are complying with the tax. Others will carry the fight into 2019.

Meanwhile, new taxes on sales of digital goods and other streaming services continue to emerge in other states. As of January 1, 2019, Iowa is taxing sales of digital audio and audio visual works, digital books and "other digital products," information services, Software as a Service (SaaS), pay television, and more. Iowa will also tax personal transportation services (think Lyft and Uber), photography and retouching services, and subscription services.

On the other hand, some states insist that services should not be taxed. Missouri prohibited the further taxation of sales in November 2016, and Arizona followed its lead in November 2018. Do two states make a trend?

Soda taxes under fire

Over the last several years, some parts of the country started taxing soda and other sugary drinks to help decrease consumption of these products and raise revenue for public health services. These so-called soda taxes seemed to be gaining momentum after being approved in several cities in California; Cook County, Illinois; Philadelphia, Pennsylvania; Seattle, Washington; and the entire state of Vermont.

But then the soda industry got serious in its opposition. The Cook County soda tax was repealed at the end of 2017. California is now prohibited from administering any local soda tax imposed after January 1, 2018. And though the Seattle sweetened beverage tax stands, other cities in Washington are now prohibited from imposing soda taxes of their own.

Big Soda may continue to take the offensive in 2019. Indeed, opposition to Philadelphia's sweetened beverage tax is expected to resurface during the 2019 mayoral race, despite the fact that it was upheld by the state Supreme Court.

Taxing big business

Portland and San Francisco will start taxing big businesses operating in the cities beginning January 1, 2019.

San Francisco will tax the gross receipts of businesses that receive more than $50 million in total taxable gross receipts annually starting January 1, 2019. The same day, Portland will start requiring large retailers to pay a 1 percent surcharge on their Portland retail sales. Starting January 1, 2019, the new tax applies to retailers with a Portland business license, more than $500,000 in annual revenue from Portland sales, and more than $1 billion in total annual revenue.

On the other hand, Seattle approved a head tax on big businesses in 2018, but then quickly changed its mind and repealed it.

Exempting big business

There's been a lot of controversy flying around taxing sales of jet fuel in Georgia, which is home to the busiest airport in the world and Delta Air Lines. On July 1, 2018, the Georgia Department of Revenue had to stop collecting any local sales and use taxes that were imposed on jet fuel after December 30, 1987. Apparently, some localities weren't always using the revenue to maintain and improve airports, as required by law.

In addition, the state was on track to exempt Delta Air Lines from the state sales tax on jet fuel until Delta stopped discounting airfare for members of the National Rifle Association; the proposed exemption was killed by angry lawmakers in the spring of 2018. The exemption was subsequently saved during a special session of the Legislature in November, but it will expire on June 30, 2019, unless the Legislature extends it. The Georgia Legislature is expected to revisit the state sales tax exemption for fuel when it reconvenes in 2019.

Like Georgia, most states provide industry-specific sales tax exemptions to encourage businesses to relocate to the state, stay in the state, or grow. And as in Georgia, these exemptions are subject to scrutiny and change.

Exempting essentials

More and more countries and states are exempting feminine hygiene products. They became exempt in the District of Columbia on October 1, 2018. Around the same time, Australian lawmakers agreed to exempt feminine hygiene products from the Goods and Services Tax (GST) and Nevada voters approved a sales tax exemption for sanitary napkins and tampons. As of January 1, 2019, certain feminine hygiene products will be exempt from tax in both Australia and Nevada.

Many states and countries exempt items deemed essential or necessary, such as food for home consumption and prescription medication. Proponents of exempting feminine hygiene products point out that they, too, are a necessity for menstruating women. Yet opponents of product-specific sales tax exemptions argue that such exemptions cost states sorely needed sales tax revenue.

Indeed, as more states exempt tampons, more are expanding their sales tax base to include previously untaxed services, such as streaming services and Software as a Service (SaaS).

Rate changes

Expect thousands of local sales and use tax rate changes in 2019, as always. In addition, some states could pursue state sales tax rate changes. Colorado recently considered raising the state rate, but the proposal was voted down in November 2018. Outgoing Governor Dannel Malloy of Connecticut was a strong proponent of a state sales tax rate increase. Will incomer Ned Lamont feel the same?

There will likely be product taxability changes as well. Arkansas has been advised to tax magazine subscriptions and exempt car washes. Connecticut could impose a statewide car tax. And there will be many temporary exemptions during state sales tax holidays.

Stay up to date on rate changes and other sales tax news by reading Avalara's blog.

Just the start

One of the most exciting – and maddening – aspects of sales tax is its mercurial nature. You can try to keep up with all the changes, or you can automate sales tax compliance and let Avalara do the heavy lifting for you.

Learn more at the Avalara Sales Tax resource hub.

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