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ON BEHALF OF THE

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON ECONOMIC GROWTH, TAX,
AND CAPITAL ACCESS

Hearing On

"*South Dakota v. Wayfair, Inc.*: How Main Street is Fairing and Whether Federal Intervention is Necessary"

March 3, 2020

Chairman Kim, Ranking Member Hern, and Members of the Subcommittee, thank you for the opportunity to testify today on behalf of the AICPA regarding the effect of the *Wayfair* Supreme Court decision on small businesses. Our testimony will focus on what the Supreme Court specifically determined in *Wayfair*, the states' reaction to the case, and how small businesses are affected. We will also provide recommendations for Congress to assist in its consideration of whether federal legislation should address these pressing issues.

Overview of the *Wayfair* Decision

On June 21, 2018, the U.S. Supreme Court issued its decision in *South Dakota v. Wayfair Inc.*, overturning the long-standing "physical presence" nexus standard previously established under Court precedent. With this ruling, the Court endorsed a South Dakota statute requiring remote sellers to register, collect and remit sales tax if they meet at least one of two economic thresholds in the prior or current calendar year – either gross revenue from sales delivered into the state exceeding $100,000, or engaging in at least 200 separate transactions involving items delivered into the state.

In finding in favor of South Dakota, the Court noted that while small businesses benefitted from the historic physical presence rule, the South Dakota statute afforded small businesses "a reasonable degree of protection" from potential undue burdens caused by an economic presence rule. The Court stated that the South Dakota statute had three features designed to prevent discrimination or undue burdens on interstate commerce: the economic thresholds protecting remote sellers that do not perform a considerable amount of business in the state; the statute not applying retroactively; and South Dakota's adoption of the Streamlined Sales and Use Tax Agreement. To the extent states might adopt economic presence rules that are burdensome on small businesses, the Court reasoned that reasonably-priced software eventually would ease the burden. The Court also stressed that to the extent problems ensued, Congress had the ability to legislate in this area if it deemed necessary to enact such legislation.

States' Responses to the Wayfair Decision

Lack of Uniformity on the Level of Economic Thresholds

Collectively, we have seen swift and dramatic state legislative and administrative responses to *Wayfair*, but such responses are not entirely consistent from state to state. Almost every state imposing a general sales tax has adopted some form of economic presence requirement on remote sellers through new statutes, regulations, and/or policy. About half of the states adopted the same alternative economic thresholds at issue in *Wayfair* – more than $100,000 in sales or at least 200 separate transactions to the in-state market will subject a remote seller to the sales tax. The other half of the states have adopted discrete variations on what constitutes economic presence subjecting a remote seller to the sales tax, including: higher thresholds of $500,000 (such as, California and Texas); a requirement that both the transaction *and* sales thresholds are met (such as, Connecticut and New York); or currently in at least one state, Kansas, economic presence once the first sale is made to an in-state customer.

Lack of Uniformity in Determining How and When Economic Thresholds Apply

In addition to the distinct differences between the economic threshold tests adopted by the states, there is a significant lack of uniformity in determining how the economic threshold tests are satisfied and when remote sellers need to comply with the sales tax. For example, in calculating the economic threshold based on sales, some states count only the amount of taxable sales that remote sellers have made to a state's customers (leaving the exempt sales out). Other states use the aggregate gross sales amount, raising the possibility that a remote seller must register (unless a state says otherwise), even in the case where the vast majority of the remote seller's sales are not subject to the sales tax because the item is for resale or subject to an exemption. Other states may specifically exclude sales for resale, but not other exempt sales, in the gross sales calculation.

In addition, businesses have no definition for the term "transaction." It is unclear whether a transaction is considered each line within an invoice, an entire invoice or a contract that is billed in installments.

Since states adopted these provisions independently, different enactment and effective dates result in a lack of uniformity with respect to when each rule begins to apply, which forces taxpayers to navigate different implementation dates from state to state.

Expansion of Economic Nexus Beyond Wayfair Fact Pattern

Inconsistent economic presence thresholds among the states that impose a general sales and use tax only scratches the surface of what small businesses must deal with in a post-*Wayfair* landscape. The *Wayfair* decision has also inspired states to adopt economic nexus legislation that reaches well beyond the sales tax issues specifically addressed in *Wayfair*. For example, since *Wayfair*, most of the states that impose a sales tax have also adopted marketplace facilitator legislation, under which remote businesses that facilitate transactions on online platforms, often between unrelated purchasers and sellers, are required to register, collect and remit sales taxes on these transactions. Further, since *Wayfair*, a number of states, including Massachusetts, Pennsylvania and Hawaii, have adopted legislation or policy imposing economic nexus standards subjecting remote businesses to these states' *income* taxes.

Issues for Small Businesses Since *Wayfair*

Given the rapid pace of change in the state and local tax treatment of remote sellers since *Wayfair*, small businesses and their accountants (many of which operate as, or are part of, small businesses themselves) face issues on a number of fronts. Prior to *Wayfair*, small businesses with physical presence in multiple jurisdictions already had to comply with a variety of sales tax registration requirements, taxability questions, invoice and exemption certificate management, collecting and remitting the proper amount of sales tax, filing returns in numerous state and local taxing jurisdictions, and responding to notices and audits from these jurisdictions. At the same time, small businesses also had to ensure compliance with widespread state and local income tax requirements.

Since *Wayfair*, it has become even more challenging to meet these requirements. Even those small businesses historically compliant in states where they are physically present are resource constrained and face financial limitations to either internally implement or outsource new and complex compliance processes. *Wayfair* and the states' response have resulted in a web of inconsistent, complicated, and burdensome state and local sales and income tax nexus rules across the country.

Prohibitive Expense of New Sales Tax Compliance Obligations

With the advent of remote seller and marketplace facilitator rules, it is markedly more expensive and time-consuming for small businesses to comply and ensure that the proper amount of sales tax is paid to state and local jurisdictions. Small businesses that traditionally maintained a small physical footprint in one or two states now must consider whether their sales to customers in a national marketplace subject them to the new rules. Small businesses must track ongoing developments in the states as remote seller legislation is addressed, while analyzing recent levels of sales and transactional data by state to determine if they have crossed an economic threshold.

If these small businesses are subject to the new rules, they must determine whether the products they sell are taxable or exempt depending on the existing rules in each state in which they are selling. To the extent such sales are exempt, small businesses must ensure that a proper exemption or resale certificate document is available. If the sales are taxable, small businesses must determine the correct state and local tax rates to charge and comply with each state's specific collection and remittance compliance obligations. Taken as a whole, there are often prohibitive costs attached to ensuring that the compliance is performed correctly, whether completed in-house with dedicated tax staff, or completely outsourced.

If left unchecked, the lack of uniformity in which the states have reacted to *Wayfair* could impair the ability of small businesses to grow, result in a loss in productivity that impairs the economy as a whole, and hamper their accountants' ability to efficiently and effectively serve them.

Unnecessary Sales Tax Registration Requirements for Businesses Making Exempt or Minimally Taxable Sales

While the post-*Wayfair* legislation adopted by the states was intended to capture additional sales tax revenue by requiring remote sellers to collect and remit sales taxes, there are instances in which remote seller registration has not led to additional revenue for the states. In states that have adopted remote seller legislation based on an economic presence threshold on the amount of gross revenue rather than taxable revenue, a small business that primarily sells goods for resale or is otherwise exempt from taxation may have to register for the sales tax and file "zero dollar" tax returns. In that case, the small business expends unnecessary time in complying with the law, and the state does not receive any additional revenue for those efforts.

Similar problems may arise when states utilize economic threshold tests based on a 200-transaction economic threshold standard rather than an economic threshold based on the value of the sales made to customers within the jurisdiction. For example, a small business selling a taxable product valued at $10 each to 200 customers in a state with an 8% sales tax in a taxable year is required to register, collect and remit a grand total of $160 (8% of the aggregate $2,000 in sales) to the state. The cost of collection borne by the small business in this instance, which includes determining when the registration requirement became effective, the effort required to ensure that the transactions are taxable, the systemic changes that the small business must make to reflect the tax on transactions to a particular state, and the tax filings required to remit the tax amounts due, clearly exceeds the $160 collected for the state.

Special Issues for Small Businesses Selling Directly and Through Marketplaces

The new rules are particularly problematic for small businesses that sell through their own websites, as well as through unrelated online marketplaces. These remote sellers must determine and navigate burdensome compliance obligations under both the remote seller and marketplace facilitator rules that most states have adopted. Some states aggregate direct sales and marketplace sales to determine whether the remote seller meets the economic threshold, which disadvantages small businesses that make significant marketplace sales and only minor quantities of direct sales.

In conclusion regarding the small business impact of *Wayfair*, small sellers are subject to an extraordinarily fragmented landscape of inconsistent and varying compliance obligations in the post-*Wayfair* world. Nexus standards, threshold calculations, rate determinations, and filing compliance are only some of the burdens on remote businesses, and especially small businesses, that do not have the necessary resources, revenue, or time to consistently and accurately comply with sales and use tax rules across the nation. Small businesses must act quickly to replicate the resources more readily available to larger, more established multistate businesses or face significant penalties.

Recommended Legislative Solutions

The AICPA has several recommendations for Congress to consider if it decides to assist small businesses with state tax simplification in light of *Wayfair*. Overall, we suggest a reasonable balance between the states' rights to tax income and sales within their borders and the needs of individuals and businesses to operate efficiently in this economic climate. Our recommendation provides a simple and reasonable economic threshold, applicable to income and sales taxes in a consistent manner across the states. In addition, we provide recommendations designed to simplify the sales tax treatment of marketplace facilitators and marketplace sellers and suggest guidelines for effective tax administration that will ease the burden on small businesses.

Consistency Between Sales and Income Tax Nexus Rules

The states' efforts to subject remote sellers to tax has highlighted for remote sellers the dual challenge when it comes to the question of nexus – are they subject to sales tax, income tax, or both? The answer in many cases is unclear, and following *Wayfair*, there is a divergence between how the sales tax and income tax nexus rules work. On the sales tax side, there are widely divergent economic threshold tests in effect. On the income tax side, most states use "doing business" standards and a few states use economic threshold tests. In addition, there is an important protection that Congress has provided pursuant to Public Law 86-272, under which businesses with limited solicitation activities (within a state with respect to sales of tangible personal property shipped from outside the state) are not subject to the state's income tax.

While it is impossible to completely align all sales and income tax regimes into one set tax policy that is uniform for all states and in all circumstances, it is possible for Congress to address the minimum standards for which both income and sales taxes will apply to a remote seller.

The MTC Factor Presence Nexus Standard for Business Activity Taxes as a Starting Point for Determining Economic Nexus Thresholds

A natural starting point in considering a consistent set of minimum economic threshold standards is the model factor presence nexus standard established by the Multistate Tax Commission (MTC) in 2002 for business entities organized outside a state. The MTC's minimum standards provide the following bright-line safe harbor *de minimis* thresholds for small businesses for each state for the purposes of imposing business activity taxes:

i. $500,000 sales in the state;
ii. $50,000 in property in the state;
iii. $50,000 in payroll in the state; or
iv. 25% of total property, total payroll or total sales in the state.

The MTC's model presence nexus standard also has rules governing inflation adjustments, sourcing rules that help determine when the sales threshold is met, and confirmation that the protections under Public Law 86-272 still apply.

Given that the MTC has not updated its factor presence nexus standard since its adoption in 2002, the AICPA recommends an update of the uniform minimum state economic nexus threshold that states could apply in a consistent manner for both the sales and income taxes. Under this recommendation, substantial nexus would apply on a prospective basis following adoption, only when at least one of the following three thresholds is met:

i. One designated threshold amount of taxable sales (for sales tax) or gross sales (for income tax) in the state;
ii. $100,000 property located in the state (for both sales and income tax); or
iii. $100,000 payroll located in the state (for both sales and income tax).

There are several potential approaches to determining an appropriate designated threshold amount of sales. As a minimum, the $500,000 amount used in the 2002 MTC's factor presence nexus standard equates to what some of the larger-market states have decided to use in their post-*Wayfair* remote seller statutes. As an alternative approach, if inflation is taken into account since the MTC's adoption of its standard in 2002, the economic threshold is approximately $750,000. As an additional approach, a $1 million in-state sales threshold is similar to the threshold for paying the Oregon gross receipts tax and would ensure that small businesses are protected from the substantial burdens of multistate sales and income tax compliance.

For the in-state sales threshold, because the taxable bases for the sales tax and the income tax substantially differ, we recommend the use of "taxable sales" for sales tax purposes, and "gross sales" sourced to the state for income tax purposes. The factor presence standard would eliminate the current transaction thresholds adopted by many states post-*Wayfair* that have negatively affected small businesses. Eliminating the transaction threshold would decrease the complexity and financial costs for small businesses, especially those businesses selling relatively low-priced products.

A factor presence threshold offers taxpayers transparency to understand if and when a tax is imposed, while offering state governments an appropriate level of predictability. It is rooted in "bright-line" standards adopted by the MTC nearly twenty years ago that would be increased for inflation and retain protections that Congress afforded to businesses in Public Law 86-272. A prospective application of the standards allows for taxpayer accountability when there is accessibility and visibility of information on tax laws. It also eliminates the use of the transactional economic threshold test that already has proven impractical for small businesses to apply, as reflected in several states rejecting the use of this test in their post-*Wayfair* legislation.

Consistent and Clear Definitions for Marketplace Facilitators

In the rush to adopt legislation post-*Wayfair* to cover the activities of marketplace facilitators, states adopted several approaches that make it exceedingly difficult on marketplace sellers that are already dealing with the remote seller rules for their own direct sales, as well as marketplace facilitators, which in many cases are small businesses themselves. As a means to simplify the analysis for marketplace sellers and facilitators and avoid situations in which the unintended double collection of sales tax may occur, we recommend a consistent and clear definition of what constitutes a marketplace facilitator (or marketplace provider, the term that many states use in place of marketplace facilitator). New York's definition of "marketplace provider" requires that a business: (i) facilitate sales of tangible personal property via agreement with a marketplace seller; (ii) provide the forum in which the sale occurs; and (iii) collect receipts paid by a customer to a marketplace seller for a sale of tangible personal property (or contract with a third party to collect such receipts). To be required to register, collect and remit sales tax, marketplace providers with no physical presence in New York also must meet the economic threshold tests applicable to remote sellers. Congress should provide a set of rules defining (and providing a mechanism for determining) who (whether it is the seller or marketplace facilitator) is required to collect and remit sales tax. The rules should include an exception to (and waiver out of) the general rule, allowing the parties to enter into an agreement on who will collect and remit the sales tax. A set of uniform rules governing marketplace facilitators will result in equity, fairness and neutrality with respect to how taxpayers engage in marketplace transactions.

Encouraging Effective Tax Administration

Finally, while the above recommendations are integral in providing a measure of uniformity at the state and local level post-*Wayfair*, we suggest additional guidelines for effective tax administration that would ease the burden on small businesses and accountants alike.

i. *Standardized Measurement Periods for Measuring Economic Thresholds*

We recommend a standardized measurement period for small businesses to determine if they exceeded economic thresholds. Specifically, the measurement period should look to the prior fiscal or calendar year to determine whether the business has met the economic thresholds for both the sales tax and income tax. That period would provide certainty, convenience, consistency, and sufficient time for small businesses to implement new systems and devise a workplan and minimize noncompliance.

ii. *90-Day Grace Period Prior to Sales Tax Obligations*

In many instances, small businesses will not know if they have reached the economic threshold in a particular state until the very end of the fiscal or calendar year. Given that uncertainty and the effort that it will take for a small business to comply with its sales tax obligations, any federal legislation should set forth an automatic 90-day grace period following the close of the fiscal or calendar year before a remote seller is required to register to collect and remit the sales tax. Providing a remote seller 90 days after exceeding the prior year threshold allows a reasonable amount of time for a remote seller to prepare to register, collect and remit the sales tax to a new jurisdiction.

iii. *Taxability Matrices*

Congress should also encourage all states to provide easily accessible taxability matrices that are updated on a regular basis to promote uniformity, certainty, and transparency. The matrices should contain definitions, treatment, statutory, administrative or other references, and comments to assist taxpayers in determining if a state includes or excludes an item from the sales price, and if a product or service is taxable or exempt. Such guidance and uniformity would substantially reduce complexity and result in easier and faster tax determinations, thereby encouraging overall taxpayer compliance as well as decreasing the burdens and costs associated with erroneous tax decisions.

Thank you for the opportunity to testify, and I am happy to answer any questions.