



THE IMPACT of *South Dakota v. Wayfair*:

HOW A RECENT U.S. SUPREME COURT DECISION ON SALES AND USE TAX POTENTIALLY CHANGES EVERYTHING AND NOTHING AT ALL IN TEXAS

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On June 21, 2018, the United States Supreme Court ruled that states can compel online retailers to collect and remit sales tax to states in which those retailers have no physical presence. This was a historic decision, as it puts brick-and-mortar retailers on a more “equal footing” with their online competitors to the extent that the latter will also have to collect and remit sales tax.

What follows is a brief review of the significance of the Supreme Court’s decision in this tax case, involving *South Dakota*, the current sales and use tax rules in Texas, and the impact that this case might have on future tax legislation in the Lone Star State.

So Why All the Fuss About *South Dakota v. Wayfair*?

In *South Dakota v. Wayfair*, No. 17-494, (decided June 21, 2018) the United States Supreme Court overturned its 1992 decision in *Quill v. North Dakota*, a case that indicated a physical presence in a state was required for the state to constitutionally impose an obligation on a retailer to remit sales and use tax to that state.

The *Wayfair* case specifically involved South Dakota’s “economic nexus law,” which obligates out-of-state sellers to collect and remit sales tax if they have more than \$100,000

of annual sales into the state or, in the alternative, more than 200 in-state transactions. South Dakota is not the only state with a law that has an “economic nexus model” and imposes an obligation on out-of-state sellers that exceed certain gross sales or transaction thresholds to collect and remit sales tax. There are approximately 20 other states with similar laws. Of those, only Tennessee, Washington and Wyoming do not impose a state income tax.

Although *Wayfair* may be a sign of changing times, typically Texas does not tend to be an early adopter of new ideas. It has yet to enact a law or adopt a regulation that creates taxable nexus based strictly on economic activity. “Nexus” exists when a company has sufficient contact with, or activity within, a state to require that person or entity to remit sales and use tax to that state. Texas currently requires some degree of activity in the state before requiring online and out-of-state retailers to remit sales and use tax.

Sales to Texas Residents

If a business operates online or out-of-state, does it have to collect and remit sales tax on sales to Texas residents? Unfortunately, it depends on a number of factors. Texas imposes a sales tax on the sale of tangible personal property and taxable services in the state. Items that are purchased outside of Texas, but stored, used or

consumed in the state, are taxed to the purchaser via a use tax.

A seller’s activity in Texas will give rise to an obligation to collect and remit sales tax if it has a “place of business” in Texas, because the seller will clearly have nexus in the state. A seller that does not have a place of business, but is otherwise “engaged in business” may also have an obligation to collect and remit sales tax in Texas. These two scenarios might seem easy to distinguish, but many retailers do not think they have a place of business in Texas when they actually do and even more sellers that do not have a place of business are otherwise “engaged in business” in Texas, but don’t know it! How is this possible?

A place of business is typically an office, an outlet or any kind of physical location operated by the seller. Although these examples might seem obvious, what constitutes a “place of business” under Texas law is quite broad. For example, a home office out of which three or more items are sold through an online auction website is a place of business. This example is part of the definition of “place of business” included in the Texas Administrative Code. Such sellers might think that because they are operating online, they do not have a “place of business” in Texas, but they would be mistaken.

The Texas Tax Code provides additional context by establishing rules that allow online and out-of-state

sellers to determine where a sale is deemed to occur and, consequently, if they have an obligation to collect and remit Texas sales tax. For example, the Texas Tax Code indicates that a seller is obligated to collect sales tax on taxable items delivered to customers in Texas if the goods sold are either stored or delivered from a location in Texas. This explains why online and out-of-state sellers that sell goods via an Amazon Fulfillment Center within the state have to collect and remit sales tax on all sales made to buyers in Texas.

Even without a “place of business,” an online or out-of-state seller might still be “engaged in business” in Texas. The Texas Administrative Code defines what it means to be “engaged in business” in Texas by providing numerous examples. Some of the examples in the statute, like “maintaining an office in the state,” make it clear that the seller is engaged in business in Texas and thus has to collect and remit sales tax. Other examples, such as “allowing a franchisee or licensee to operate under its trade name in this state if the franchisee or licensee is required to collect sales or use tax in this state,” are less intuitive.

Section §151.107(a)(5) of the Texas Tax Code imposes on online and out-of-state sellers an obligation to collect sales and use tax without establishing either gross receipts or transactional activity thresholds that would constitute “economic nexus” under Wayfair. The statute indicates:

“[A] retailer is engaged in business in this state if the retailer... (5) solicits orders for taxable items by mail or through other media and under federal law is subject to or permitted to be made subject to the jurisdiction of this state for purposes of collecting the taxes imposed by this chapter”

This language ostensibly imposes on all online and out-of-state sellers with customers in Texas an obligation to collect and remit sales tax by deeming

Companies that are not already calculating, collecting and remitting sales tax for their online sales may have to update their systems to add this capability in Texas and other states where they have sales.

them to be “engaged in business” in the state regardless of their level of activity.

An online or out-of-state seller that is deemed to be “engaged in business” in Texas has to obtain a sales and use tax permit from the Texas Comptroller and would be responsible for collecting and remitting sales and use tax until it ceases to have “nexus.”

Why Worry Now?

Unlike South Dakota, Texas has yet to enact a law or adopt a regulation that creates nexus based strictly on economic activity and whether or not such a statute will be adopted in the next legislative session is anybody’s guess. That said, there are those who believe that such legislation is not needed. The current Texas Comptroller of Public Accounts, the Honorable Glenn Hegar, issued a memo dated July 5, 2018, in which he stated:

“With appropriate notice, and prior to legislative action, Tax Code § 151.107(a)(5) (Retailer Engaged in Business in the State) could be imposed on remote sellers to the extent they “[solicit] orders for taxable items by mail or through other media,” meaning, for example, sellers who solicit sales in Texas through catalogs and emails.”

Simply put: The Texas Comptroller believes that both online and out-of-state sellers have an obligation to collect and remit Texas sales tax under the current statutory framework. The lack of a gross sales or transaction threshold might expose the current

framework to legal challenges such as the one South Dakota faced in the Wayfair case. The Comptroller anticipates this, as his memo also indicates, “we are reviewing agency rules that need amending to ... explain the amount of economic nexus in sales and/or transactions required to create a safe harbor for small sellers.”

It probably does not bode well for online and out-of-state sellers because, like South Dakota, Texas does not impose a state income tax and relies heavily on sales and use tax revenue to fund essential services. According to an article published on July 9, 2018, in the online version of *The Dallas Morning News*, in 2014, the former Comptroller estimated that Texas could gain more than \$1 billion in combined state and local taxes if internet sales were taxed. While this number might have gone down given that large online sellers like Amazon are currently collecting and remitting Texas sales tax, we believe that we will see increased efforts to enforce existing rules and guidelines that apply to online and out-of-state sellers as Texas tries to increase sales and use tax collections.

Overall, the U.S. Supreme Court’s decision in Wayfair serves as both a reminder of existing obligations and a sign of things to come for taxpayers doing business in Texas.

Next Steps

The Texas Comptroller indicated that there would be no retroactive application of the new law to remote sellers that have no physical presence in the state. Nevertheless, his office is currently reviewing statutes that may need to be updated when the legislature convenes in 2019 in light of the Wayfair decision.

In the meantime, companies that are not already calculating, collecting and remitting sales tax for their online sales may have to update their systems to add this capability in Texas and other states where they have

sales regardless of physical presence. This could represent a significant challenge to mid-size businesses that will fall under the minimum presence thresholds and are not already collecting sales information and filing the necessary returns. Even companies with mostly nontaxable sales may be required to register for sales tax purposes and collect certificates to support any untaxed sales in the event of an audit.

Regardless of whether there is an actual “place of business” in Texas or someone operates remotely, but is “engaged in business” in the state, it is critical to comply with sales and use tax reporting and remittance requirements. It is best for businesses to work with a tax professional who can provide the guidance to help them get up to date with their obligations and minimize their exposure to penalties and interest. ❁

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WAYFAIR

SUPREME COURT RULING BRINGS SALES TAX COMPLIANCE CHALLENGES

In June, the U.S. Supreme Court decided what is arguably the most important state tax case of the last 25 years in *South Dakota vs. Wayfair*.

The decision overruled the sales and use tax nexus standard of physical presence as it applied to South Dakota’s sales/transaction-based sales and use tax nexus statutes affecting remote seller transactions, clearing the way for more sales tax revenue from internet purchases.

To help TSCPA members keep informed and be ready to advise their employers and clients, several upcoming CPE webcasts are scheduled. **Register today!**

Webcast: Pay Up! Wayfair Creates Virtual Presence Standard

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