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Impact of Wayfair Supreme Court Decision on Nonprofit Organizations

By Katherine Gauntt

Sales tax is imposed upon retail sales of tangible personal property and taxable services in 45 states and the District of Columbia. Each state determines the circumstances under which a sales tax is imposed on the purchaser.

Purchases by nonprofit organizations are exempt in most of the states, if the tangible personal property or taxable services are used or consumed exclusively for the purposes for which the organization was established. The states usually require each legal entity to register as a nonprofit entity with the state to receive state tax-exempt status. Upon state authorization, the entity can provide a state-approved exemption certificate to its vendors in order to purchase goods and services without paying sales tax.

While nonprofit organizations can make purchases free of sales tax, their sales of goods and taxable services are usually taxable. One could argue that these sales ultimately benefit the organizations' nonprofit activities but most states do not extend the nonprofit exemption. Many organizations selling promotional goods on their websites are registered in their home state but rarely are registered in multiple states to collect sales tax. Usually they have no "physical presence" in states beyond their home state and did not have to collect the sales tax. However, everything changed on June 21, 2018 when the U.S. Supreme Court held in *South Dakota v. Wayfair*[1] that states can require a retailer to collect and remit sales tax even if the retailer lacks an in-state physical presence.

History of the Wayfair Case

Effective May 1, 2016, South Dakota passed a law requiring remote sellers to remit sales tax on all taxable sales if the seller's gross revenue from the sale of products or taxable services delivered into South Dakota exceeded $100,000 or 200 or more separate transactions. Wayfair, Inc., Overstock.com, Inc. and Newegg Inc. refused to comply on the basis that they had no physical presence in South Dakota and, therefore, were not obligated to collect the sales tax. South Dakota filed a declaratory judgment action in state court. The case was fast-tracked through the South Dakota lower courts. Ultimately, the South Dakota Supreme Court, compelled by the 1992 U.S. Supreme Court decision in *Quill*,[2] found in favor of the Wayfair, Inc. et al. The U.S. Supreme Court in *Quill* affirmed that "substantial nexus" under the U.S. Constitution's Commerce Clause required a business to have a physical presence within a state before the state could impose tax or a tax collection obligation.

Nonetheless, the ultimate goal was a U.S. Supreme Court challenge to overturn *Quill*. On January 12, 2018, the U.S. Supreme Court granted South Dakota's petition for a Writ of Certiorari with respect to the *Wayfair* case. Oral argument was heard on April 17, 2018. And on June 21, 2018 the U.S. Supreme Court overruled *Quill* and the physical presence standard.[3] The Court then ruled that South Dakota's sales tax economic nexus statute was constitutional and "substantial nexus" under the Commerce Clause. In anticipation of the ruling, many states already had laws on the books which were designed to go into effect if the ruling was favorable. As of October 15, 2018, 35 states have passed some form of economic nexus standard for sales tax purposes.

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Wayfair Impact and Action Items for Nonprofits

All industries are likely to see an impact from the *Wayfair* decision, but industries selling goods and taxable services remotely over the internet at retail have the greatest exposure. Nonprofits carry the same burdens as for-profit e-commerce sellers for taxable goods and services, if their sales reach the economic thresholds established by the states. (For the latest information on thresholds by state go to: https://www.bdo.com/wayfair.) When it comes to *Wayfair*, it's also important to keep in mind that all states aren't equal. The following are areas that nonprofit organizations should review to mitigate their risk of overpaying or under-collecting the sales tax.

Administration

Most states require nonprofits to register with the state departments of revenue if they are eligible for a sales tax exemption on purchases. In addition, once the economic thresholds are reached, the nonprofit must register as a vendor with the state since its sales will likely be treated the same as for-profit vendors. Again, each state is different regarding its nonprofit tax registration requirements.

Purchases

As a result of *Wayfair*, more sellers will be required to collect sales tax. Many of these sellers either "assume" everything they sell to nonprofits is exempt from tax or default all sales to taxable without consideration for nonprofit status. Either way, nonprofits must be proactive in informing their vendors when to charge them sales tax or they could end up overpaying sales tax on purchases or underpaying and creating a use tax assessment if they are audited. Each vendor's sales should be reviewed to ensure that, if no sales tax is charged, the sale qualifies for the nonprofit exemption (i.e., the purchase benefits the organization's nonprofit activities). It is important to establish an exemption certificate policy to ensure that only those vendors selling qualified goods and services are given an exemption certificate. Providing an exemption certificate to a vendor shifts the liability for the tax to the nonprofit even if it is provided in error. Areas where sales to nonprofits are generally taxable include sales of food, lodging, certain types of software and supplies such as uniforms, furniture and fixtures or any other type of sale unrelated to the purpose for which nonprofit status was granted by the state.

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Sales

Nonprofits should examine their sales volumes in each state and compare it to the economic nexus thresholds established by each state. In general, measurement should be done at a legal entity level if there is more than one legal entity doing business in the state (although some states may combine sales of affiliated legal entities.) For tangible products, the state where sales occur is determined by the delivery address. However certain nonprofits, especially in healthcare, sell tangible goods, digital products (e.g., e-books) and services. In addition, some are part of an organization of affiliated companies consisting of nonprofit and for-profit entities. Nonprofits should consider the following when developing an action plan for determining nexus and potentially charging sales tax:

1. Where are the tangible goods, digital products and services sold?
2. Do the sales reach the threshold for economic nexus?
3. If yes, what are the necessary actions needed for complying?
    - **Registration** – Nonprofits should register as a vendor in each tax jurisdiction.
    - **Taxability of Products Sold** – A determination of the tax status of each product sold should be made.
    - **Exemption Certificate Procedures** – If products are sold to other nonprofits, a process to collect exemption certificates should be established.
    - **Billing Sales Tax** – A process must be established to charge the correct sales tax on an invoice. To do so, the nonprofit must utilize the most current sales tax rates to charge its customers.
    - **Reporting** – Depending on volumes, sales tax reporting can be in-house or outsourced through third parties. Most states have portals where tax returns can be filed by keying in the data manually if the nonprofit has established economic nexus in only a few states.
4. In addition, nonprofits should consider their internal operational capabilities:
    - **Accounting** – Do you have Sales Tax Liability Accounts set up that can undergo reconciliation and audits?
    - **Technology** – Do you have the functionality in your billing system to charge the correct tax on taxable sales?

- **Resources** – Do you have enough resources in-house to administer exemption certificates and tax reporting?
- **Document Retention** – Most states require retention of all invoices, work papers, tax returns and other supporting documentation to support the taxes reported.

Conclusion

Wayfair has impacted every organization in the country in one form or another. Not all nonprofits sell goods and services, but they may see an uptick in the costs of the things they buy as a result. Those that do sell, must perform their own due diligence and incur the costs of compliance just like any other company dealing with the complexities of 46 different state tax jurisdictions with 46 different sets of rules. The rules are still evolving but one thing is certain: Unless Congress acts to change the economic nexus standards established by the *Wayfair* case, every entity, including nonprofit entities, that buys or sells will incur extra costs in its attempt to comply with current law.

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[1] *South Dakota v. Wayfair, Inc.* 585 U.S.__(2018)

[2] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)

[2] In addition to *Quill, National Bellas Hess v. Department of Revenue,* 386 U.S. 753, 87 S.Ct. 1389 (1967), was also overruled.