



# The new normal in sales tax regulatory and enforcement trends

Changing nexus rules, new digital taxes, and aggressive audits



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Tax professionals that are searching for a unifying theme to describe the mishmash of sales and use tax challenges that loom large in 2022 may feel like it's "business as unusual."

On the one hand, all states with sales taxes have enacted economic nexus rules after the *Wayfair* case that upended the longstanding physical presence standard. But on the other hand, states continue to fiddle with economic nexus rules (e.g., transaction thresholds appear to be falling out of favor), and physical presence remains a highly relevant nexus factor. Plus, the outcomes of several legal challenges could have major ripple effects on nexus rules. "The challenges facing companies, and smaller businesses in particular, in complying with these economic nexus rules are really quite burdensome," notes Diane Yetter, president of YETTER Tax and founder of the Sales Tax Institute.

Sales tax audits are back in business, returning to pre-pandemic levels of frequency (and intensity). At the same time, many auditors remain reluctant to return to on-site audits, preferring the ease and efficiency of virtual audits supported by e-rooms and data transmissions. Also, many state auditing groups are taking hard looks at remote sellers to scrutinize their compliance with post-*Wayfair* rules and registration dates.

Other challenges loom, including an onslaught of newly proposed digital tax legislation at the state level. "While relatively few states tax services, more and more are realizing that digital services related to the analytics derived from e-commerce transactions and other online interactions are very, very valuable to marketers," notes Vertex Vice President, Tax Content and Chief Tax Officer, Michael J. Bernard. "As a result, more states are trying to make the sale of that information subject to sales tax. And that's just one of three common forms of digital taxation arising in many state legislatures."

A confounding grab bag of sales tax issues will continue to challenge tax groups this year. The uncertainty makes it pivotal for tax professionals to keep abreast of changing nexus rules (and the litigation influencing them), new digital tax proposals, and audit and enforcement trends.

To do so, tax leaders need to get the right talent, technology, and external relationships in place. "Accounting firms play a valuable role as a trusted advisor to their client companies in numerous areas, including sales tax compliance," notes Product Manager at CPA.com, Brett Weinberg. "Leading accounting firms share high-value insights and risk mitigation approaches for tax compliance that help client companies future-proof their businesses."

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## Nexus: expect the unexpected

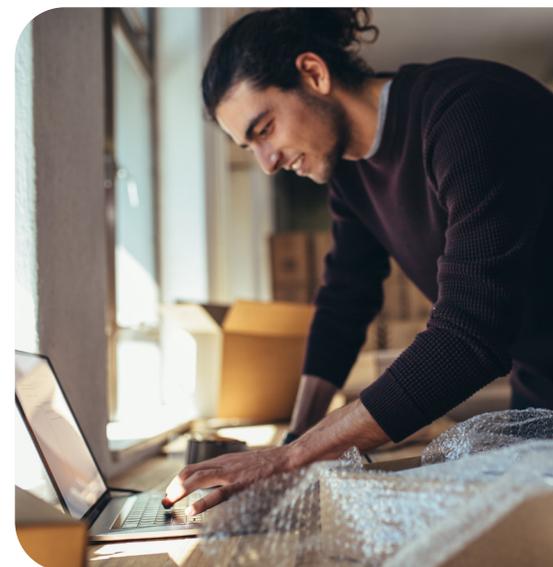
Now that nearly four years have elapsed since the U.S. Supreme Court's *Wayfair* ruling, the final three states (with sales tax laws on the books) without economic and marketplace nexus finally joined the club, [according to the Sales Tax Institute](#). Florida, Kansas, and Missouri (whose law will not take effect until January 2023) became the final states to enact legislation based on the economic nexus standard contained within the *Wayfair* ruling. This does not mean that transaction tax teams should expect to see standard, simplified economic nexus and marketplace rules across most states to materialize any time soon.

Yetter reports that many states continue to tinker with their definitions of economic nexus, especially regarding the transaction-count thresholds that trigger requirements for remote sellers to register to collect and remit sales tax in a particular state. That's just one of many nexus factors that Yetter and Bernard identify. Others to know about:

- Marketplaces also matter:** In addition to economic nexus rules, states have also enacted new laws and rules governing who is responsible for the collection of sales tax in marketplace transactions between remote sellers and in-state buyers. Given the responsibility of the marketplace to collect the tax, some states – like Illinois – exclude these marketplace sales from the threshold calculation in determining when a seller establishes economic nexus. Yetter stresses that the term “marketplace” applies to a wide range and growing number of online, as well as offline, platforms that extend well beyond the most well-known digital marketplaces. “There are thousands of different types of marketplaces out there,” she notes, “and you need to be aware of which marketplaces you’re selling on and which party has the responsibility to collect sales tax.”
- Transaction thresholds may be falling out of favor:** “While it’s currently more of a slight trend than a widespread trend, we’re seeing more states realize that the transaction threshold is not an effective measurement of whether or not a seller has substantial presence within the state,” Yetter reports. The *Wayfair* case focused on South Dakota’s economic nexus thresholds of \$100,000 in annual sales (by remote sellers to South Dakota residents) or 200 annual transactions. Many states adopted similar thresholds soon after the *Wayfair* ruling. (Larger states including California, Texas, and New York opted for larger revenue thresholds of \$500,000.) Washington, Colorado, and Iowa dropped the transaction-count thresholds that they originally enacted. More recently, Wisconsin and Maine eliminated their transaction threshold. Florida, Kansas, and Missouri did not enact their post-*Wayfair* economic and marketplace nexus rules until mid-2021, and neither law contained transaction thresholds.
- Physical nexus remains relevant:** Despite the *Wayfair* ruling’s elevation of economic nexus, physical nexus remains a pivotal determinant of sales tax liability in many states, including several that are clarifying their definitions of physical presence. Illinois, for example, deems a company that maintains physical inventory in a third-party warehouse when the seller does not control the inventory in the state to still be a remote seller for sales tax purposes. The pandemic-driven work-from-home mobilization can also affect physical presence determination, as can the location of logistics activities and inventory stashes.

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- **Local jurisdictions can complicate nexus:** Local taxing jurisdictions in the same state add complexity to any sales tax determination. Home rule locals may not have enacted economic nexus provisions and even if they have, there is certainly an argument that the additional burden to comply with independent tax authorities won’t pass a constitutionality challenge. But it isn’t just the home rule locals that spark additional layers of complexity. Yetter points to Missouri, with its high number of local-taxing jurisdictions already posing significant sales tax compliance complexity. In June of 2021, Missouri enacted legislation making it the final state (among those with a sales tax) to adopt post-*Wayfair* economic sales tax and marketplace nexus standards. Local jurisdictions could impose use tax for sellers that have physical presence in the state, but not for remote sellers without a physical presence in the state. And that issue is why the effective date is delayed until January 1, 2023, as local referendums are required to make the final determination as to what will happen on a locality level.
- **Simplification models are welcome:** Bernard praises tax practitioners and companies that have advocated for the implementation of more streamlined sales and use tax systems. These efforts have resulted in the introduction of simplified models in jurisdictions within Alabama and Colorado. “States really need to make things much easier for taxpayers,” he continues. “We encourage the taxpayer community to continue their good work in pursuit of sales tax simplification.”
- **Know your measurement dates:** Most taxpayers have concentrated on the registration dates of new economic nexus requirements for good reason. More taxpayers should focus similar attention on the measurement dates of economic nexus thresholds. Misunderstanding those dates can lead to registering sooner than is required, Bernard notes. Many states tally revenue and transaction totals based on the calendar year. If a remote seller surpasses the state’s threshold, it is obligated to register for sales and use tax as of January 1 of the following calendar year. Other states use a rolling 12-month measurement period or a rolling four-quarter time frame. Others may require collection on the very next transaction. States also vary on how they measure revenue (taxable sales versus retail sales versus gross sales) and whether marketplace sales are included in threshold calculations. “Be sure to check those rules so you know when you are required to register. Knowing how to calculate when you had a collection and registration responsibility can even impact your exposure for prior periods,” says Yetter, [whose firm tracks these rules.](#)
- **Global rules also come into play:** “Similar remote-seller provisions are cropping up around the world,” says Bernard, noting that the rules primarily apply to companies conducting business-to-consumer e-commerce with customers based outside the United States. “You really have to pay attention if you’re selling to consumers in Australia, New Zealand, the U.K., as well as the entire EU.” New VAT requirements on e-commerce transactions to overseas buyers add one more layer of complexity to international transactions that often come with currency exchange challenges and customs charges.

Keep in mind that the nature of these rules can change swiftly due to several factors, including the outcome of several nexus-related legal challenges. Bernard and Yetter report that the outcomes of three cases in particular could have significant impacts:

1. **U.S. Auto Parts Network Inc. v. Commissioner of Revenue**: A challenge to Massachusetts' cookie nexus rule
2. **Halstead Bead, Inc. v. Lewis**: A case in which the plaintiff is arguing that the compliance burden that Louisiana's sales tax system places on out-of-state sellers is unconstitutional
3. **Online Merchants Guild v. Maduros**: While a federal judge dismissed the e-commerce trade group's request to prevent California from retroactively collecting sales taxes from sellers with inventory warehoused in fulfillment centers in the state, the judge indicated that the case must be filed in state court (which seems likely to occur this year)

## Digital taxes: three flavors, two challenges

Nexus-related litigations are not the only sales tax legal challenges expected to play out in 2022. The outcome of a case involving Maryland's groundbreaking digital advertising tax will also have substantial implications on U.S. sales tax compliance activities.

Bernard reports that digital tax legislation proposals continue to materialize in more state legislatures. These proposals typically fall into one of the following categories (although several states are pursuing new legislation in more than one digital tax category):

1. **Taxes on digital products**: Sales taxes will apply to video streaming services, digital music platforms, and similar services. More than a dozen states (and localities like Chicago) already apply these types of taxes, Bernard notes, and plenty more plan to follow suit.
2. **Taxes on the sale of personal data**: These digital taxes apply to the sale of data and related analytics generated by e-commerce transactions and other online activities.
3. **Digital advertising taxes**: These rules, including Maryland's new law, tend to target social media platforms and the advertising revenue they generate.

The Maryland law that is currently moving through state courts likely will not be decided until the later part of 2022, according to Bernard. In the meantime, tax groups whose companies are, or likely will be, subject to digital taxes should address two compliance challenges.

The first issue relates to how digital services and products are commonly bundled together into a single offering. If a digital tax applies to only one of those services, tax professionals should ensure that the tax is accurately and appropriately applied to the specific service subject to sales tax. The second issue relates to sourcing, which helps prevent inadvertent instances of double taxation. "Tax groups will really have to be vigilant on the sourcing of the digital taxation," Bernard points out. "That requires pinpointing the zip code and billing address where a customer downloads or consumes the digital offering."



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## Audit and enforcement trends

As state sales tax audits return to pre-pandemic levels, newly aggressive auditors are scrutinizing remote sellers to assess their compliance with economic nexus rules and registration requirements that have come online since the *Wayfair* ruling in 2018. Yetter’s experience indicates that the following states appear especially dogged in their pursuit of remote sellers that may have been late to register to collect and submit sales taxes:

- Illinois: pursuing back to October 2018 via desk audits
- Maine: pursuing back to July 2018 via desk audits
- Massachusetts: pursued under cookie nexus, which will likely continue while an appeal by the state is pending
- New York: pursuing back to February 2019 even though the economic effective date is June 21, 2018
- Ohio: registration for sales tax can result in the state’s pursuit of the commercial activity tax
- Washington: not only is there sales tax exposure risk but also risk under the notice and reporting requirements that were subsequently repealed (taxpayers have been successful in obtaining waivers of the minimum \$20,000 penalty via voluntary disclosure agreements)
- Wisconsin: pursuing back to October 2018 via desk audits (taxpayers have had success getting penalties abated and interest reduced even with notice)

“We just passed three years from the date when many states passed new economic nexus and marketplace nexus rules,” Yetter notes, “so we’re going to see audits in this area really pick up.”

Auditors also will be looking beyond remote sellers as they hit their post-pandemic strides. Expect exemptions to come under the auditing microscope. Yetter also reports that more states are conducting audits remotely, even as other pandemic mandates subside. “Audit processes are undergoing changes,” she adds. “You’re going to see a lot more e-rooms and a lot more data exchanged electronically in lieu of on-site visits.”

## Conclusion: people, process, technology, and trust

The ripple effects of the 2018 *Wayfair* ruling, pandemic-driven budgeting shortfalls and climbing costs (which also wallop state and local governments) ensure that sales tax compliance activities will come under strain throughout 2022 and into 2023.

Ongoing sales and use tax rules changes, enforcement shifts, and auditing activity requires tax leaders to remain agile. Putting in place the right talent, processes, and technology tools enables agile responses while freeing up precious transaction tax resources to perform higher-value activities. External relationships with trusted advisors – including sales and use tax experts, tax technology providers, and accounting firms – also help tax professionals contend with compliance challenges and elevate their strategic contributions.

Weinberg notes that the tax group's external providers also collaborate with each other, which strengthens the expertise, insights, and solutions that they deliver. He points to the CPA.com and Vertex [Firm Advisor Program](#), which “combines cutting-edge technology with a real-world understanding of corporate tax software and services” to support clients' needs and ensure sales and use tax compliance. For firms seeking to develop their sales tax expertise, CPA.com and the [Sales Tax Institute](#) have partnered to offer training on sales tax concepts as well as on how to build and sustain a sales tax practice.

This type of collaboration among external partners helps “simplify the complexity of keeping up with thousands of jurisdictions and rapidly changing sales tax rates,” Weinberg adds. “Which in turn, allows accounting firms to expand their trusted advisor role while helping to ensure that client companies remain compliant to avoid audits and hefty penalties.” That will become increasingly important as unusual sales tax compliance challenges become the new normal.

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