



Legislative trends: 2022 U.S. sales tax

Rulings and litigation reshaping
sales tax rules and rates



The father of modern economics, Adam Smith, developed his “invisible hand” concept to describe hidden forces that exert a powerful influence on a free market.

A similar dynamic exists in state capitol buildings, departments of revenue, and courtrooms where decisions and rulings have implications on how current and future sales tax laws and rules are designed, interpreted, and enforced. Although these proceedings are not concealed from the public, they often occur outside the scope of busy transaction tax groups contending with competing priorities and resource constraints amid ongoing digital transformation efforts.

A slew of states proposed various forms of digital service taxes in 2021. This year, numerous tax laws and rulings related to post-*Wayfair* nexus requirements – including those that affect the rapidly growing volume of marketplace transactions – will be finalized, clarified, and enforced following a brief, pandemic-induced lag. While tax groups get their arms around two sets of significant changes, they will also need to keep an eye on legal cases and appeals that will influence future rule changes.

Given the array of influences that will shape sales tax rules and rates in the coming months, PwC Tax Partner, Sue Haffield, encourages transaction tax teams to:

- Recognize significant tax issues that emerged in 2021
- Prepare to respond to policy changes that are likely to occur in 2022
- Keep abreast of noteworthy federal and state legal proceedings and impacts on corporate taxpayers

“Keep in mind that some important 2021 legislative and policy issues will not be finalized until this year,” notes Larry Mellon, Tax Director, Chief Tax Office at Vertex. “A number of important federal and state court cases – including those involving class action suits and false claim assertions – also seem likely to reach a resolution in 2022.”

» “Keep in mind that some important 2021 legislative and policy issues will not be finalized until this year.”

– Larry Mellon, Tax Director, Chief Tax Office at Vertex



Digital taxes took off in 2021

Digital taxes have crossed the pond – and the Rubicon.

Digital taxes that began cropping up in the European Union over the past couple of years reached Maryland’s eastern shore in 2021 when the state enacted a first-of-its kind (in the U.S.) digital advertising tax. The act was first introduced in the Maryland legislature in 2020, where it was met with a veto by Governor Larry Hogan. In February 2021, the legislature overrode the veto. A few months later, in June, Maryland lawmakers enacted legislation to delay the law – technically speaking, a digital advertising gross revenue tax – by one year and to retroactively amend the state’s digital products sales tax.

Digital tax legislation and policies in both the EU and Maryland are important given that U.S. states look to these rules when drafting their own digital tax laws, as many states did last year and will continue to do in 2021 and beyond.

The European Commission has expressed a desire to reach consensus among its member countries concerning a standard approach to digital taxation, one that takes into account the rapidly increasing use of e-commerce, social media, and the selling of consumer data. That consensus remains elusive, so individual countries such as Spain, Italy, and others are implementing their own digital tax laws designed as interim measures.

“Global companies are well aware of new digital taxes in Europe,” Mellon notes. “These rules require tax groups to look closely at where their customers are located, what their offerings are being used for, and new thresholds that pertain to their digital services revenue.”

Tax teams should also look closely at Maryland’s groundbreaking digital advertising tax law, particularly the legal challenges it triggered. The Maryland law’s many stipulations — including its application to gross revenue based on company size, how it defines a digital product, organizations that are exempt from it, and how it treats apportionment among facets — will be scrutinized by legislators in other states as they draft new digital tax proposals in 2022. “Maryland is a big state, and other states are following suit by proposing similar rules,” Mellon says. “Tax groups, of course, need a detailed understanding of new and emerging digital tax rules to ensure that they properly assess tax.”

To that end, it is helpful to distinguish among several different types of digital tax rules that were proposed by states in 2021 and appear all but certain to materialize in other states in the future:

- **Digital advertising taxes** have been proposed in Louisiana, New York (two different bills), Texas (two different bills), Massachusetts, Montana, Washington, West Virginia, and South Carolina (a bill that taxes digital services beyond advertising).
- **Social media focused digital advertising taxes** have been proposed in Arkansas, Connecticut, and Indiana (two bills).
- **Taxes on the sale of personal data/information** were introduced in Massachusetts, New York (two bills), Oregon, Washington, and West Virginia.

A digital tax bill that fails to clear one legislative session may return, in the same or similar format, for additional consideration in a subsequent legislative session. It’s also important to recognize that Maryland started a trend with irreversible tax compliance consequences, [according to the American Bar Association](#), “Maryland has become the first state in the nation to impose a tax on digital advertising services. It is certain not to be the last.”

» “Maryland has become the first state in the nation to impose a tax on digital advertising services. It is certain not to be the last.”

— the American Bar Association



New nexus and marketplace rules

Groundbreaking legal rulings with sweeping implications, such as the U.S. Supreme Court's 2018 *South Dakota v. Wayfair* decision, take time to work their way into legal standards and compliance practices.

While *Wayfair* rewrote the long-standing physical presence nexus standard by requiring out-of-state sellers and marketplace facilitators who meet certain conditions to collect and remit sales tax on sales to in-state consumers, nexus remains a major policy focal point as legal challenges to the initial rounds of post-*Wayfair* tax laws work their way through the courts. The outcomes of these state and district challenges often result in clarifications or more extensive changes; they can also influence other states to change their rules and enforcement practices.

"Nexus is definitely an issue that warrants close attention in 2022," Haffield emphasizes while ticking off a list of recent court rulings concerning nexus and marketplace facilitator requirements in Louisiana, California, North Carolina, and Missouri.

Missouri Department of Revenue clarified marketplace-seller compliance responsibilities while the North Carolina Superior Court cited the commerce clause of the U.S. Constitution in a ruling that precludes sales tax on transactions in which title and possession of goods (in this case books, magazines, and catalogs) transferred to North Carolina purchasers outside the state. Texas enacted legislation in late 2021 that amended its previous definition of a "marketplace provider." The Lone Star State separately determined that fees paid to marketplace facilitators are taxable as data processing.

This rundown represents only a sampling of a larger collection of ongoing nexus and marketplace rule changes that tax groups should monitor and address. Doing so is not easy, Haffield notes, especially when the transactions subject to these changing laws and rules take place in digital marketplaces. In these increasingly common transactions, sellers and marketplaces often have difficulty determining collection responsibilities due to:

- Challenges in navigating responsibility for other taxes and fees
- Dual reporting responsibilities for facilitator and seller
- Broad definitions of marketplace facilitator in many states creates ambiguity on which party qualifies as a marketplace facilitator
- Resistance of some marketplace sellers to letting marketplaces collect and remit tax
- Challenges with sourcing laws
- State auditors' lack of familiarity with marketplace transaction dynamics
- Local tax efforts to enact and apply marketplace laws



Case studies

A large and diverse collection of legal proceedings will also continue to influence how post-*Wayfair* sales tax rules are written, clarified, and enforced. These court cases include those that took place in 2021, as well as ongoing and emerging legal challenges.

Recent notable proceedings include litigation pitting companies against state treasuries and departments of revenue, appeals of previous challenges, class-action suits, and false claim assertions. These legal cases are occurring in Wisconsin and Arkansas, as well as in larger states such as New York and California.

Haffield points out that the subjects of these legal challenges also vary significantly. Sales and use tax ambiguities concerning marketplace sales of non-medical masks and software apportionment, transactions between wireless services and device manufacturers, aircraft sales, and sales of energy drinks triggered legal challenges and rulings in 2021 that will continue to reverberate in 2022.

Several of these legal challenges pivot on whether an offering — one that frequently involves data and supporting technology — should be interpreted as a product subject to sales tax or a service that is exempt from sales tax. When a company is under audit and a service or product issue arises, Haffield says that the tax team should emphasize the reasoning behind its interpretation to the auditor. “Auditors remain very aggressive in this area,” she adds.

Mellon’s recent work and interactions with transaction tax teams confirms Haffield’s point on aggressive audits. “We see more companies disagreeing with what a jurisdiction deems as taxable and how they classify what the company sells,” Mellon reports. “Tax groups should keep in mind that they know how to classify what they sell, and that the auditor is in the business of looking at transactions and then issuing their opinion on rulings. Don’t always automatically accept the auditor’s opinion and move on.”

» “Tax groups should keep in mind that they know how to classify what they sell ... Don’t always automatically accept the auditor’s opinion and move on.”

— Larry Mellon, Tax Director, Chief Tax Office at Vertex



Conclusion

Precedents and internal practices

There's another reason tax groups should monitor notable sales tax litigation cases: The rationale and rulings in these proceedings can shed valuable light on the importance of certain tax compliance practices inside organizations.

In September 2021, for example, the Supreme Court of New York dismissed a false claim assertion that the state's attorney general brought against B&H Foto concerning the taxability of incentive payments that the company receives from vendors, which are used to discount products sold to customers. (False claims describe cases where a state challenges the taxpayer on the basis that it defrauded the state.) The court ultimately dismissed the assertion by the state of New York while ruling that B&H Foto was not contractually required to pass along the discount as the customer did not present a coupon (or "consideration") to receive the discount.

"New York went after B&H pretty hard," Haffield reports. "But B&H had a provision in its contract stating that it was not required to use funds [from incentive payments] to mark down the price of a product. This demonstrates that it is extremely important to examine contracts from a tax compliance perspective."

This type of ruling shows why highly-rational tax groups avoid a *laissez-faire* approach to monitoring legislative and legal trends. Instead, leading tax teams invest the time and effort needed to monitor prominent legislative efforts, nexus-related decisions, and court proceedings related to post-*Wayfair* sales tax rules and clarifications.

For more information about Vertex, visit vertexinc.com or follow Vertex on Twitter [@vertexinc](https://twitter.com/vertexinc).



© 2022 PwC. All rights reserved. PwC refers to the US member firm or one of its subsidiaries or affiliates, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. This content is for general purposes only, and should not be used as a substitute for consultation with professional advisors.

About Vertex

Vertex Inc., is a leading global provider of indirect tax software and solutions. The company's mission is to deliver the most trusted tax technology enabling global businesses to transact, comply, and grow with confidence. Vertex provides solutions that can be tailored to specific industries for major lines of indirect tax, including sales and consumer use, value added, and payroll. Headquartered in North America, and with offices in South America and Europe, Vertex employs over 1,300 professionals and serves companies across the globe.

To learn more, visit vertexinc.com.



North America | Latin America | Europe | Asia Pacific



©2022 Vertex Inc. All rights reserved. Vertex and the Vertex logo are all trademarks of Vertex Inc. All other trademarks are used for identification purposes only and are properties of their respective owners. 5.22

vertexinc.com