Middle market businesses should prepare for compliance changes under the Marketplace Fairness Act

September 10, 2013

In brief

Although the potential impact of federal legislation requiring remote sales tax collection (the Marketplace Fairness Act or MFA) has been focused mainly on large internet retailers, this legislation could have a substantial impact on any middle market business making sales in multiple states or pursuing an e-commerce strategy.

While viewed and promoted as an 'internet seller' bill, MFA would affect **any** business that makes sales over $1 million annually into states in which it does not file sales tax returns (e.g., states without 'nexus'). MFA would allow a state to collect sales tax from any 'remote seller' making a 'remote sale' into the state, which would result in significant additional compliance responsibilities for businesses.

With the Senate passage of MFA in May on a bipartisan basis, the bill has taken a major step toward becoming law. As a result, it is essential for middle market companies to begin analyzing the ramifications of this legislation and preparing to develop and implement a compliance process accordingly.

In detail

Features of the proposed law

Under current law, sales tax collection is required only if the business has physical presence (property or sales people), or 'nexus,' in the state. MFA would change this rule by authorizing each state to require sales tax collection from any 'remote seller' making a 'remote sale' into that state. A remote sale is defined as a sale that would be taxable but for the fact that the seller does not have nexus in the state. Thus, any taxable item sold from an out-of-state location would be subject to sales tax collection in the destination state (if there are annual sales of over $1 million and if the state has simplified sales tax collection procedures; see below).

MFA also would require states to simplify the sales tax collection process for remote sellers. The following are the minimum simplification measures MFA would require states to implement for remote sellers (but not for sellers with nexus):

- A single tax return for the state and its local jurisdictions;
- A single place to file all state and local tax returns;
- A single audit per state;
- Published matrices of taxable and exempt products to be relied upon by remote sellers;
- Published tax rate databases;
- Uniform tax bases within a state between a state and its localities;

- Free software capable of calculating and remitting tax in all states; and
- Relief from tax and penalty liability for incorrect collection, remittance, or non-collection of tax as the result of an error by the software provider.

Recommended implementation measures

If MFA is enacted, middle market businesses should consider utilizing the following implementation measures:

- Determine where the company is making remote sales;
- Determine which states have adopted the required simplification procedures ('MFA state');
- Register to collect the sales tax as a 'remote seller' (assuming no nexus) in MFA states;
- Review the taxability of the company's products in each MFA state;
- Develop and implement a compliance process, including whether to:
  - Select free software;
  - Use existing software; or
  - Use a certified service provider;
- If utilizing software, populate the software with tax decisions and test results;
- Prepare and file the necessary tax returns;
- Track law changes (base changes); and
- Maintain taxability of new products.

Potential challenges of MFA

Since MFA would apply only to remote sellers, states most likely would have separate requirements for nexus and non-nexus taxpayers. The result would be a 'two-tiered' compliance system for businesses: one system for taxpayers that have nexus in the state and a separate process for remote sellers falling under the MFA provisions.

Although the legislation would require free software to be provided by the states that is capable of calculating tax in all states, each state must separately certify the software of its choosing. If, for example, New York does not certify a software solution that other states have approved, this creates a potential scenario in which New York would not allow a taxpayer to rely on this particular software even though other states would protect the taxpayer from tax and penalty liability as a result of software provider error.

Furthermore, if a remote seller begins using the free software, and eventually establishes nexus in the state, the remote seller presumably would be required to use something other than the free software provided by the state. In addition, if nexus eventually is established, different compliance procedures such as separate local tax filings may be required.

Once a remote seller is registered with a state, there is a greater potential for scrutiny by that state's taxing authority. The possibility exists for the state to audit the remote seller and assert it had nexus prior to the passage of MFA. To prevent such an unwelcome surprise, a review of current activities performed in states in which sales tax currently is not being collected may be appropriate.

Finally, MFA mandates that states provide remote sellers with software free of charge; however, free software does not mean that there would be no costs associated with MFA compliance. Many middle market businesses would be required to undergo software upgrades and other implementation and integration changes. In addition, although MFA states would be required to publish information regarding taxability of certain products and services, middle market businesses would have to make taxability determinations for all their products. Middle market companies should be having discussions regarding their current compliance systems to determine their ability to implement new collection and reporting requirements under MFA.

The takeaway

Following Senate passage in May with bipartisan support, MFA is inching closer to becoming law. If enacted, MFA would affect many businesses in addition to large internet retailers. The legislation would affect any middle market business making sales in multiple states.

Because many middle market companies may be making sales in states in which they do not have nexus, MFA would create a sales tax collection responsibility. As a result, it is essential for middle market companies to begin reviewing their current activities in various states to better understand and prepare for the impact of this legislation if it is enacted.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC Private Company Services representative, or one of the subject matter professionals listed below:

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