

Drop Shipping Post-Wayfair

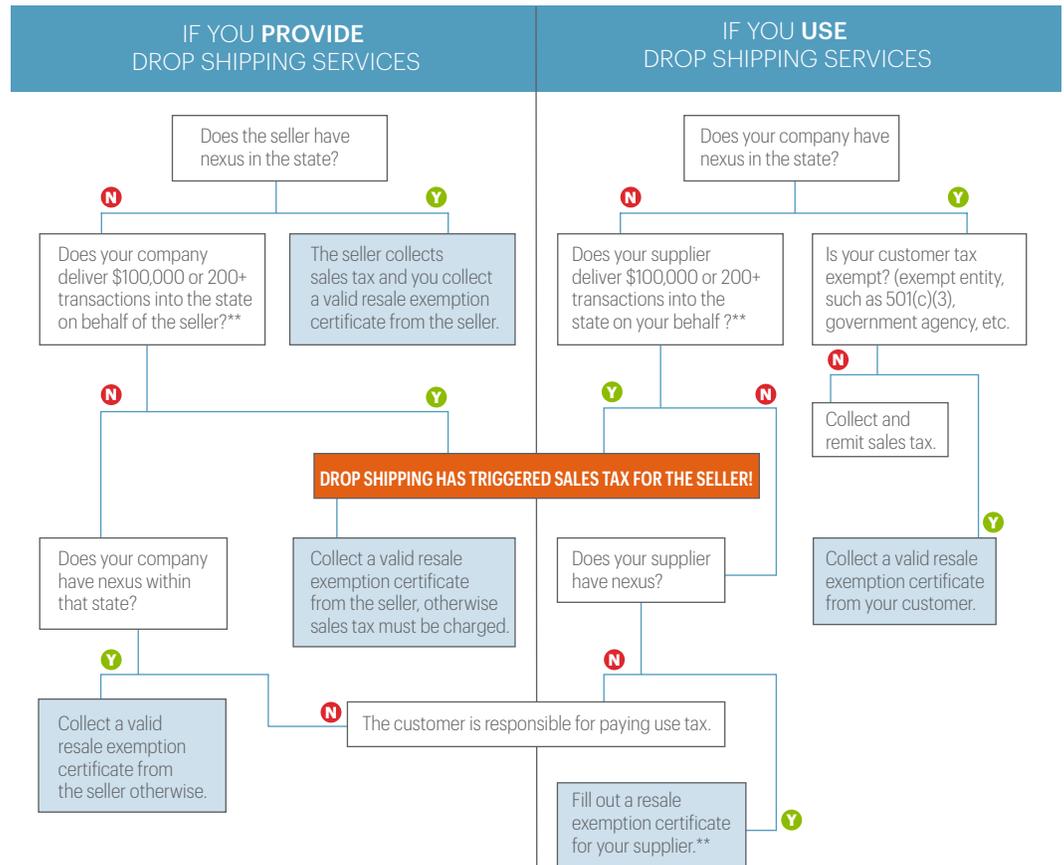
Tax Advisory Group

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Drop shipping is a fundamental aspect of the supply chain and represents two separate and distinct transactions.

This document provides a guide on how drop shipping relationships have changed following the new tax laws and regulations after the decision in *South Dakota v. Wayfair*.

Drop shipping is a fundamental aspect of the supply chain and represents two separate and distinct transactions. The seller accepts orders from their customers, invoices the customers and receives a shipping address. That shipping address can be in a state in which the seller has a presence or any other state that the seller is not located in. The seller then places an order with the supplier to fulfill the customer's order who will ship that product directly to the shipping address provided. The supplier never invoices or deals directly with the customer; they engage in a sale solely with the seller.



DEFINITIONS

Seller: The company that accepts the order from a customer and invoices that customer for the order.

Supplier: The company that delivers the product to the customer.

Customer: The person or entity who places the order.

**Laws vary by state. Contact your HBK advisor for more information.

South Dakota v. Wayfair has had a substantial impact on sales tax across the United States. As of January 1, 2019, 31 states have implemented some form of economic nexus under *Wayfair*. By mid-2019 each of the 46 jurisdictions (45 states and D.C.) that have a sales tax will have some type of economic nexus rule. Under these rules, companies with sales into the taxing state exceeding the state specific threshold (i.e. gross sales exceeding \$100,000, \$250,000 or \$500,000) are deemed to have nexus in the state, even though the company does not have any type of physical presence within that state. Exceeding a state's economic nexus threshold often creates a registration and filing obligation within that state.

Additionally, along with these new economic nexus thresholds, companies still need to track their physical presence, ensuring that they comply with any registration and filing obligations in states where they have employees, property or facilities such as warehouses.

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The impact of *Wayfair* can create significant issues for companies that provide or use drop shipment services. Most states consider sales of tangible personal property to be taxable unless the seller obtains a valid exemption certificate, typically referred to as a resale exemption certificate. A resale certificate must be valid in the state where the property is shipped, since that is the state where the sale from the supplier to the seller occurs. Failure to obtain a valid resale exemption certificate can cause the supplier to be liable for collecting sales tax on the transaction. If tax is not charged and it is determined under audit that the supplier did not have a valid resale certificate, the supplier will likely be assessed back sales tax and interest on the price charged on the drop shipment sale made to the seller.

Some states will not accept the home state resale certificate from the seller and will require the seller to register for sales tax within that state to obtain a valid exemption certificate. Some states accept other states exemption certificates, and some states accept the multi-state exemption certificates, but tracking these nuanced provisions can be tricky. In some cases, it may be more economical for sellers to simply pay the tax to the supplier rather than to incur the compliance costs related to collecting and remitting the sales tax in additional states. Requiring sellers under the economic nexus threshold to secure a specific, state-issued registration number so that a valid resale certificate can be issued in some ways violates the benefit of imposing economic nexus thresholds, which are intended to provide a "safe harbor" for small businesses.

Moreover, there are some states, like California, that are hyper vigilant in enforcing their rules on drop shipment relationships and have enacted separate provisions laying out the treatment for each party involved. Sellers and suppliers alike are starting to see push back on exemption certificate acceptance, and could be facing an increased registration obligation or an increased sales tax obligation as they engage in drop shipment relationships post *Wayfair*. If you have any questions on this or other sales tax matters, please contact your HBK advisor.



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Ms. Baubie joined HBK in 2017. She works in the firm's Youngstown, Ohio, office after earning a dual Bachelor of Arts degree in legal studies and psychology from the State University of New York, The University at Buffalo and a Juris Doctorate from the University of Pittsburgh School of Law, where she also completed a tax law certification. She graduated from both schools with high honors.

Ms. Baubie has experience in tax law research. Prior to joining HBK, she worked for Jurist.org, a global legal news organization, and was a member of the University of Pittsburgh *Tax Law Review Journal*. Ms. Baubie also worked for the University of Pittsburgh School of Law's Low Income Tax Clinic where she performed IRS litigation and tax court work and provided compliance work for low income individuals and businesses.

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