Current developments in multistate sales and use tax

State and Local Tax

June 5, 2019
Notice

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Key areas of development

Sales and use tax developments relating to:

— Manufacturing Exemptions

— Software and Saas

— Other

Wayfair Update
Sales and use tax - manufacturing exemptions
Sales and use tax - manufacturing exemption

**Horsehead Corp. v. Ill. Dep’t of Rev. and Ill. Tax. Trib. (Illinois Sept. 24, 2018)**

- The Appellate Court affirmed that a taxpayer owed use tax on its purchases of Metallurgical coke (“coke”) used and consumed in its kilns during its manufacturing process
  - The taxpayer argued the coke was exempt as a catalyst used in the manufacturing process
  - The Illinois manufacturing exemption covers chemicals acting as catalysts, but only if they effect a direct and immediate change upon a product being manufactured
  - The Illinois Tax Tribunal ruled that the coke did not have a “direct” and “immediate” change upon a product being manufactured
  - Simply placing coke next to zinc did not create a chemical reaction; rather, the heating of the coke created a series of chemical reactions that took place over several hours and resulted in the creation of several compounds and gases that were all necessary to produce a change to the manufactured product
Sales and use tax - manufacturing exemption


• The Indiana Supreme Court held that purchases of freezer equipment and electricity qualified for certain sales and use tax exemptions for manufacturing activities
  • The taxpayer operated a food freezing and storage facility in Indiana
  • Indiana law exempts the purchase of equipment and electricity from sales and use tax if 1) the taxpayer is engaged in producing TPP, and 2) the equipment purchased is essential and integral to the production process
• The court determined that the taxpayer engaged in producing a distinct marketable good by transforming its customer’s food into blast-frozen food; the exemption statute did not require the taxpayer to be engaged in its own production
  • The taxpayer only needed to prove that it was engaged in the business of manufacturing or processing, not that its blast freezing represented a separate, stand-alone process with its own distinct marketable good
Sales and use tax - manufacturing exemption

*Accel, Inc. v. Testa* (Ohio Dec. 6, 2017)

- The key issue before the Ohio Supreme Court was whether packaging materials used in developing gift baskets were exempt from sales and use tax.
- Under Ohio law, a sales and use tax exemption applies to purchases that are incorporated into tangible personal property produced for sale by manufacturing, assembling, processing, or refining.
  - In contrast, there is no exemption for purchases of items used in packaging operations, and packaging is specifically excluded from the definition of a “manufacturing operation” and of “assembly” or “assembling”.
- The taxpayer argued that it was engaged in manufacturing or assembling.
- The court held that the taxpayer was engaged in both packaging and assembling and therefore qualified for the exemption.
  - A finding that the taxpayer was engaged in packaging did not preclude a finding that it was also engaged in assembly.
Sales and use tax - manufacturing exemption


• The Texas Court of Appeals addressed whether the taxpayer’s purchase of software tools to design and develop a semiconductor chip were exempt from sales and use tax under Texas’ manufacturing exemption

• Taxpayer argued that the software was “necessary” and “essential” for manufacturing the semiconductor chip because creating the design was the first step in the “actual” manufacturing process
  • The court held the taxpayer failed to “clearly show” that the software tools were “directly used…in or during the actual manufacturing…of tangible personal property for ultimate sale”
  • Also, the tools were used to create the design file, which was in preparation for the manufacturing of the chip, not the first stage of production

• Taxpayer also argued, in the alternative, exemption under the definition of “semiconductor fabrication cleanrooms and equipment”
  • The court rejected this argument, finding that the taxpayer failed to show a “reasonable nexus” with the third-party’s cleanroom equipment used for fabricating the semiconductor chips
Sales and use tax - software and Saas
Sales and use tax - multistate credits


- The tax court held that the taxpayer was entitled to a credit against Indiana use tax for local use taxes paid to the Texas Comptroller.
- The taxpayer received software and loaded it on its servers in Texas.
  - The taxpayer remitted use tax to the Texas Comptroller, two percent of which represented local use taxes.
- A taxpayer is entitled to a credit against Indiana use tax equal to the amount of sales or use tax paid to another state, territory, or U.S. possession.
- At issue was whether the taxpayer was entitled to a credit for the tax paid to the Texas Comptroller but later allocated back to Texas localities.
- The tax court held that the critical fact is the identity of the payee, which is restricted to another state, territory, or U.S. possession.
  - As such, taxpayers are entitled to credit even if a state distributes a portion of a taxpayer’s payment to a state municipality.
  - There was no requirement to look beyond the payee to the ultimate recipient of the tax.
Memorandum of Decision No. 04-20170483R (Ind. Dep’t of State Rev. Nov. 29, 2017)

- The issue was whether a taxpayer was entitled to a refund of sales taxes paid on access to an online database of real property listings
  - The taxpayer was a professional organization for real estate professionals, who were given online access to a database of real estate listings created by a vendor under contract with the taxpayer
    - The members of the taxpayer’s organization supplied the listing information to the vendor and the vendor standardized the format of the information, and provided it in an online searchable database
    - Under the agreement between the taxpayer and the vendor, the taxpayer maintained ownership of the data provided to the vendor
  - The Department concluded that the taxpayer had purchased a nontaxable service and was entitled to the sales and use tax refund because the information compiled was provided by the same entity buying the final product
    - Also, neither the taxpayer or its members gained control of the underlying database software
Sales and use tax - software


• The Massachusetts Appellate Tax Board ruled that a taxpayer’s software products were taxable sales of prewritten computer software transferred electronically
  • The taxpayer provided three types of online software to help create and maintain a screen-sharing connection between a host and other remote computers
    • The software was sold by subscription and was not customizable, although there were enhancements available to all customers
  • The Board first determined that the taxpayer’s products were not exempt from sales or use tax as customized software, as the software was not prepared according to a purchaser’s specifications
  • The Board next held that although Massachusetts law enumerated specific types of software “transfers,” the imposition of tax, per a regulation, on the “transfer of rights to use software installed on a remote service” was reasonable
    • The statute intended to create a uniform tax treatment of standardized software regardless of delivery method
Sales and use tax - multiple points of use exemption


- The Appellate Tax Board, on its own motion, vacated its previous decision upholding the denial of a refund claim based on a “multiple points of use” or MPU exemption
- A Departmental rule provides—in part—that a software seller is relieved from collecting tax if the purchaser provides an MPU exemption certificate to the seller before the transaction is reported for sales tax purposes
  - In such a case, the purchaser would remit tax based on the relative use of the software in Massachusetts
- The Board rejected the Department argument that the taxpayer’s refund claim should be denied because the purchaser did not provide an MPU exemption certificate before sales tax was remitted
  - The Department’s regulation allows for apportioning tax if no exemption certificate is provided to the seller
  - In such case, the seller may work with the purchaser to correctly apportion the tax based on the purchaser’s business records
- While the taxpayer was required to remit the full amount of tax without an exemption certificate, nothing in the statute or the Department’s regulation prohibited the taxpayer from filing refund claims using generally applicable refund procedures after working with the purchaser to determine the correct apportionment of tax to Massachusetts
Sales and use tax - SaaS


- The issue was whether a taxpayer’s annual subscription charges were subject sales and use tax as remotely accessed software or were exempt scheduling services
  - The taxpayer charged customers for access to a web-based interface that helped customers manage employee schedules
  - The taxpayer’s customers sent the taxpayer each employee’s schedule, and the taxpayer populated schedule into the interface, then allowed customers and their employees to access the interface to manipulate schedules
- Under Tennessee law, sales and use tax applies to charges for access to remotely-housed software
- The Department ruled that under the true object test, the subscribers were not purchasing scheduling services, but were purchasing access to the software
  - The interface was not merely incidental to the services; it was a necessary component, without which the services would be of no value to subscribers
Sales and use tax - online classes


• The Texas Comptroller held that an online education provider was not subject to sales and use tax on charges for access to online educational courses

• Access to these courses was usually free, but the taxpayer charged for access to certain “Signature Track” courses for which a student could obtain credit at a partner university

• The Comptroller examined whether the “Signature Track” courses were taxable as a cable television service
  • The Comptroller held that the courses were not taxable as a cable television service because they were primarily instructional in nature

• The Comptroller next examined whether the “Signature Track” courses were taxable as an information service
  • The Comptroller concluded that the taxpayer’s services were not information services, as the taxpayer did not compile information for customers, but provided instruction and verified that enrolled students were competent in the subject matter taught in a course
Sales and use tax – other
Walther v. FLIS Enterprises, Inc. (Ark. March 1, 2018)

• The issue before Arkansas’ highest court was whether a fast-food retailer that provided free meals to managers owed use tax on the cost of the raw food ingredients or the retail value of the prepared meals
  • Under an Arkansas regulation, if the withdrawn goods were processed or manufactured, use tax was owed on the sales price of the products, rather than the value of the raw materials used to manufacture or produce the products
  • If the withdrawn goods were purchased goods, then use tax was owed on the purchase price of the goods
• The taxpayer argued that the meals were not processed or manufactured, so the regulatory provisions requiring tax to be remitted on the retail sales price did not apply
  • The court rejected this argument, noting that the taxpayer was creating or producing meals and was providing those complete meals, rather than individual ingredients, to its managers
  • Furthermore, in the court’s view, it would be an absurd result if the restaurant was required to determine the true value of the raw ingredients
Sales and use tax - crowdfunding

Opinion No. 20180923 (Ark. Dep’t of Fin. and Admin. Oct. 15, 2018)
- Arkansas Department of Finance and Administration held that a taxpayer was subject to sales and use tax for running a crowdfunding campaign to generate funds to produce copies of a card game
  - Once the requisite funds were raised, the taxpayer planned to send investors a copy of the card game
  - The Department concluded that the investments were consideration for the transfer of title to the card games (i.e., tangible personal property)
    - There was an expectation that those contributing would receive a card game
  - The taxpayer was required to remit sales tax based on the entire consideration paid by Arkansas investors
Sales and use tax - taxable services

Admin. Hearing Decision, No. 18-454 (Ark. Dep’t of Fin. and Admin. Nov. 5, 2018)

- An ALJ held that sediment removal services were taxable when they were performed in conjunction with non-taxable inspection services
- The taxpayer, a water service provider, was required to have its water tanks inspected every five years
  - In addition to inspecting the tanks, the inspector removed sediment from the tanks
- Under Arkansas Law, collection and disposal of solid waste is a taxable service
  - “Solid waste” is broadly defined as "any garbage or refuse, sludge from a wastewater treatment plant, water supply treatment plant, or air pollution control facility, and other discarded material…”
- The ALJ ruled that pumping and removing the sediment constituted collection of solid waste
  - The collection was not incidental to the inspection service because taxpayer had to remove the sediment and inspect the water tanks every five years
- The ALJ also rejected the taxpayer’s position that sediment was not “disposed of” when it was just left on the ground
  - The statute required tax be charged on every aspect of handling solid waste
Sales and use tax - out-of-state delivery


- The taxpayer, an out-of-state seller of orthopedic implants, purchased surgical instruments delivered by common carrier into California and used by the taxpayer’s customers to surgically embed the taxpayer’s orthopedic implants
  - At all times, the taxpayer maintained ownership of the instruments, took depreciation on the instruments, and had the right to request return of the instruments (which it rarely did)
  - However, the medical facilities were also entitled to destroy the tools upon obsolescence, and the taxpayer maintained that the instruments were intended to remain at the medical facilities indefinitely
- The taxpayer argued that it made an out-of-state gift of the tools when it transferred them to a common carrier for delivery into California
- The Board agreed and held that the taxpayer made a conditional gift of the instruments because the customers essentially received title when they received the instruments
  - Because the instruments were shipped from outside California, the gifts were completed outside of the state and use tax was not due
Sales and use tax - governmental body exclusion


- The Illinois Independent Tax Tribunal held that purchases made by a taxpayer that operated a golf course owned by a municipality were exempt from Illinois use tax.
- Under Illinois law, an exemption applies to items purchased by a governmental body.
- The Department’s regulations provide that a contractor’s purchases in fulfilling a contract with a governmental body are generally taxable.
  - However, purchases can be structured to qualify as exempt sales for resale if:
    1. the contract between the purchaser and the governmental body requires the purchaser to provide tangible personal property to the governmental body, and
    2. the contract specifies that the tangible personal property is transferred to the governmental body.
- The Tribunal held that the taxpayer met both conditions under its management agreement.
  - The agreement provided that any property distributed to the golf club became the property of the municipal government body.
Sales and use tax - taxable services

*Lowe’s Home Centers, LLC v. Iowa Dep’t of Rev. (Iowa Dec. 14, 2018)*

- The Iowa Supreme Court held that a home improvement retailer owed sales tax on certain installation services performed by subcontractors related to a customer’s purchase of custom storm windows and doors, faucets, toilets, built-in dishwashers, ceiling fans, patio doors, interior and exterior doors, sinks, vanities, and garbage disposals
  - Sales tax was collected only for the sale of the products, goods, and materials, not the installation services
  - Under Iowa law, sales tax is imposed on services, including “electrical and electronic repair and installation” and “pipe fitting and plumbing”
  - Iowa provides an exemption for services related to new construction, reconstruction, alteration, expansion, and remodeling
  - The court determined that many of the installation services were taxable as “electrical and electronic repair and installation” and “pipe fitting and plumbing” services
  - The Department’s regulations stated that these types of services included both installations and repairs
  - The services were not exempt as new construction or remodeling because they did not involve the scale of structural changes required by regulation to be considered construction or remodeling
Sales and use tax - definition of “use”

In re BHCMC, LLC (Kan. Dec. 29, 2017)

- The issue was whether a casino owed use tax on electronic gaming machines it did not and could not own
  - The machines were purchased by the taxpayer out-of-state and used in the operation of a Kansas casino, but the legal owner and operator was the State of Kansas by and through the Kansas Lottery
  - “Use” is defined in part as the exercise within Kansas “by any person of any right or power over tangible personal property incident to the ownership of that property”
    - The court determined that reasonable minds could differ on whether this definition required ownership
  - Because the law was ambiguous the court resolved the ambiguity in the taxpayer’s favor and held use tax was not owed
    - A taxpayer could only be required to pay use tax if it was the owner of the property and exercised a right/power incident to that ownership
Sales and use tax - sales tax holidays


- The issue before the court was whether the taxpayer’s sales were completed outside the scope of sales tax holidays when the orders were taken prior to the holiday, but cancelled and rewritten during the holiday period
  - The taxpayer had an established policy of allowing orders to be cancelled any time before delivery occurred
  - Each year, during the holiday periods, thousands of customers cancelled sales of items that were not yet delivered and reordered during the holiday periods
- The Commissioner argued that the sales at issue were not “paid in full” during the tax holiday because when rewriting orders, the taxpayer did not refund payments and recharge credit cards
  - The Board disagreed, holding that the statute did not require any particular payment method for “payment in full” to occur and that the taxpayer’s method was reasonable given the burden of complying with the mandatory holidays
- The Commissioner argued that the sales were “prior sales,” which are excluded from the scope of the holiday
  - The Board disagreed because neither title or possession passed to the customer prior to the good being delivered and any merchandise already delivered were not eligible for cancellation and reordering
Interventional Center for Pain Management v. Dep’t of Rev. (Mo. Admin. Hearing Comm. Nov. 8, 2018)

- The Missouri Administrative Hearing Commission addressed whether taxpayer, a medical clinic treating patients’ pain, owed use tax on certain items used to prepare and administer drugs to patients
  - The taxpayer mixed together various drugs and used multiple purchased items, such as needles, filters, syringes, catheters, and cannulas, to achieve the necessary therapeutic effect
  - Missouri provides an exemption from use tax for “materials used or consumed in the manufacturing, processing, compounding…of any product”
- The Commission held that the taxpayer’s purchases were not exempt from use tax
  - The items at issue were similar to “supplies,” rather than “materials” and the legislature deliberately excluded the term “supplies” from the exemption statute
  - Although the taxpayer appeared to be compounding the drugs, other Missouri courts have interpreted “compounding” to mean engaging in large scale industrial activities
    - The taxpayer’s operation did not appear to be a large scale industrial operation
Sales and use tax - information services


• State appellate court held that competitive pricing reports purchased by the taxpayer were not a taxable information service
  • The taxpayer, a supermarket chain, purchased competitive price audits or price checks from another company
  • Under New York law, sales tax is imposed upon the service of furnishing information, including reports, but there is a carve-out for furnishing “information which is personal or individual in nature”
• The court ruled that the reports were personal or individual in nature
  • Although the information collected was available to the public, it was not derived from a singular, widely available common source or database, as was the case in earlier disputes involving the exclusion
Sales and use tax – sale-for-resale exemption

**Cincinnati Reds, LLC v. Testa (Ohio Nov. 21, 2018)**

- The Ohio Supreme Court held that promotional items purchased for distribution at specific baseball games were exempt from use tax as sales-for-resale
  - The baseball team, the Cincinnati Reds, purchased items, such as bobbleheads, player cards, and other team-themed gear that were given to patrons on certain game with a likelihood of lower attendance
  - The taxpayer protested the state’s assessment of use tax on the purchases of the items arguing that the promotional items were purchased for the purpose of being “resold” to attendees
  - The court concluded that the taxpayer created an expectation that if a ticket for the advertised game was purchased, fans would receive a promotional item if they attended the game
  - This expectation constituted consideration for the promotional item
  - Moreover, the court concluded that despite ticket prices of popular and less desirable games being the same, the ticket price for the less desirable games included the cost of the promotional item
Sales and use tax - taxable services

Great Lakes Bar Control, Inc. v. Testa (Ohio Dec. 27, 2018)

- The Ohio Supreme Court held that cleaning beer-tap lines did not constitute a taxable building and janitorial service
  - Over time, beer-tap lines accumulate sediment, and the taxpayer’s service removed such buildup by agitating the lines or injecting compressed gas into the system
  - Under Ohio law, sales and use tax applies to “building and janitorial services,” which are defined as “cleaning the interior or exterior of a building and any tangible personal property located therein”
  - Because “cleaning” was not specifically defined in the statute, the court looked to the ordinary meaning of “cleaning” in the context of janitorial services
    - Janitorial cleaning generally includes activities such as “washing floors or windows, removing garbage, vacuuming, dusting, and the like”
    - The activities of inspecting and flushing beer-tap lines did not fit within the statute
  - The court also rejected the dissent’s view that the service was taxable because it was the “cleaning” of “tangible personal property” located in a building
    - The court held that such interpretation would be overly inclusive of activities that were clearly non-janitorial cleaning
Sales and use tax - trade-in exclusion


- The Washington Court of Appeals addressed whether a retailer that gave a store credit to customers who traded in old video game hardware and software was entitled to the “trade-in exclusion” from sales and use tax when a customer later bought software or hardware with the credit
  - The taxpayer allowed the trade-in credit from video-gaming hardware to be applied to computer games and *vice versa*
  - On audit, the Department asserted that the taxpayer owed tax on the full value of the property purchased with the store credit
- The court held video-game hardware and software were not trade-in property of “like kind” because they did not perform the same function or use and taxpayer’s records did not show “separately stated trade-in property” as required
  - The hardware had many uses beyond playing video games, whereas the software was only used to play a game
  - This was consistent with the Department’s rule
Wayfair update
Reactions to Wayfair - 5/24/2019

A. Economic nexus with effective date

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B. Other

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* New York guidance -- issued 1.15.2019 -- indicated that existing statutory thresholds became effective “immediately” after Wayfair (6.21.2018) and vendors meeting the thresholds should register “immediately.”

² Colorado’s economic nexus rule was to go into effect December 1, 2018, but the Department announced a grace period through May 31, 2019.
Economic Nexus

Provisions Adopted as of May 24, 2019

- Economic Nexus
- Economic Nexus + Software-related Presence
- Economic Nexus Not Yet in Effect
- Collect-or-Report
- No Economic Nexus
- No Sales Tax

Alaska
D.C.
Hawaii
Puerto Rico
### A. Marketplace Provider Collection Obligation

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### B. Other Obligation

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<th>Alabama (collect-or-report)</th>
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¹ In ongoing litigation, South Carolina is taking the position that a marketplace provider meets the statutory definition of “retailer” required to collect tax on 3rd party sales on its platform. On April 26, 2019, the governor signed legislation, which codifies South Carolina’s position effective immediately.

² Between January 1, 2018 and July 1, 2019, Washington had a notice and reporting option for a marketplace facilitator with $10,000 in Washington sales that did not meet the higher economic nexus threshold for sales tax collection.

³ Marketplace facilitators with at least $100,000 in Pennsylvania must collect; marketplace facilitators that do not meet the threshold, but have $10,000 in Pennsylvania sales, may have a collect or report obligation.

⁴ Rhode Island and West Virginia also impose a sales tax collection and remittance obligation on “referrers” as defined in their respective statutes.
Questions?
Thank you

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