



## The Incredible Growing Sales Tax

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The state and local sales tax landscape is constantly shifting as the marketplace of goods and services evolves. Recently, there has been a series of changes related to states expanding their sales tax. First, states are expanding their jurisdiction to impose sales tax, i.e., increasing the number of people subject to tax through nexus. Second, states have attempted to expand the sales tax base by subjecting new transactions and services to tax.

### I. The Jurisdictional Expansion of Sales Tax

#### A. Economic Nexus

States have expanded their jurisdiction to subject vendors to tax collection and remittance requirements based on economic nexus. Since the Supreme Court's 2018 *Wayfair* decision, every state imposing a sales tax has adopted some form of economic nexus threshold. Generally, these thresholds vary from \$100,000 to \$500,000 in gross or taxable sales and/or 100-200 transactions within the current or preceding year. Florida and Missouri were the latest states to adopt such thresholds; Florida adopted a \$100,000 threshold effective July 1, 2021, and Missouri adopted a \$100,000 threshold effective January 1, 2023.<sup>1</sup>

Although economic nexus thresholds have generally been accepted as permissible following *Wayfair*, questions around the retroactive effect of *Wayfair* continue to percolate across the United States. In Massachusetts, an appellate tax board (the "board") rejected an attempted retroactive application of the *Wayfair* decision.<sup>2</sup> There, the state was attempting to assert that an out-of-state retailer had nexus with Massachusetts prior to the state's adoption of an economic nexus standard by way of the retailer's cookies and apps placed on Massachusetts customers'

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<sup>1</sup> See Fla. Stat. § 212.0596; see also Mo. Rev. Stat. § 144.605(2)(f).

<sup>2</sup> See *U.S. Auto Parts Network, Inc. v. Comm'n of Revenue*, Mass. App. Tax Bd., Docket No. C339523, Dec. 7, 2021.

phones.<sup>3</sup> The board disagreed with the state and found that upholding nexus in such circumstances would be an unfair application and interpretation of *Wayfair*.<sup>4</sup> By contrast, an Oregon tax court was recently asked to determine whether the state's *Wayfair* nexus rules could apply retroactively.<sup>5</sup> In dictum, the court found that *Wayfair* could apply retroactively to the facts at hand after weighing competing concerns, including whether the retroactive application would create harsh results to litigants who relied on prior judicial rule, whether disparate treatment to litigants whose claims arise on one side or the other of the rule would result, and whether such a decision shifts the role of the courts from interpreters to creators of law.<sup>6</sup>

Although sales tax economic nexus thresholds, and the implementation of them, continue to pose issues for remote retailers throughout the United States, retailers must also keep track of their physical presence throughout the various states as workforces increasingly become remote because of the coronavirus (COVID-19) pandemic.

## B. Physical Presence

In a recent study from Upwork, 2.4% of those surveyed reported already moving because of remote work since 2020, while an additional 9.3% reported planning to move because of remote work (up from 6.1% in October 2020), and 28% reported moving outside of commutable distances from their “assigned” office spaces.<sup>7</sup> With such a profound shift of the American workforce in just over two years, vendors must consider whether the physical presence nexus remote employees may create for them throughout the United States is a business impact they are willing to take on.

In determining whether to confront the sales tax impact of a remote workforce, vendors should be sure to consider the following five critical questions –

1. Whether the activities of the vendor's remote employees will exceed any available protections under PL 86-272<sup>8</sup>

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<sup>3</sup> *Id.*

<sup>4</sup> *Id.* (noting no precedent relied upon by the State could be interpreted to support “the notion that a taxing authority may apply a court ruling retroactively against taxpayers who were acting consistently with then-current law”).

<sup>5</sup> See *Global Hookah Distrib. Inc. v. Dep't of Revenue No. TC5272*, 2021 WL 3732047 (Or. Tax Ct., Regular Div., Aug. 6, 2021).

<sup>6</sup> *Id.*

<sup>7</sup> Jack Kelly, *Upwork Study Says 19 Million Americans Plan On Relocating Due To Remote Work—Is This Likely Now That Omicron Subsided?* (March 14, 2022), <https://www.forbes.com/sites/jackkelly/2022/03/14/upwork-study-says-19-million-americans-plan-on-relocating-due-to-remote-work-is-this-likely-now-that-omicron-subsided/?sh=31a1339e1e7c>.

<sup>8</sup> P.L. 86-272 (preventing states from imposing a net income tax on an out-of-state seller if the seller's only activities within the state consist of the solicitation of orders for sales of tangible personal property which are sent for approval and fulfilled from a point outside of the state).

2. Whether the vendor's goods/services are taxable in the jurisdictions where said remote employees may be providing services
3. Whether the vendor is willing and/or able to satisfy the additional compliance burdens that will come along with being deemed to have nexus in additional jurisdictions
4. Whether any remote employees were only temporarily operating in other jurisdictions and, as a result, if those temporary operations are protected by state COVID-19 nexus waivers
5. Whether the benefits of allowing employees to work remotely outweigh the additional burdens and tax implications to the business.

Considering the above questions *before* permitting employees to perform services in a particular jurisdiction will be critical to a vendor's ability to manage its sales tax nexus profile across the United States. This is particularly important because, though taxpayers have little control over their economic nexus, they can manage the impact that physical presence nexus may have on their business. Moreover, managing such nexus may allow vendors to avoid time-consuming state and local registrations, continuous compliance requirements, and costly state audits that can be a drain on businesses for years at a time.

### C. Local Burden

The expansion of jurisdiction to tax can also be seen at the local level as localities in certain states continue to struggle with fairly applying their tax collection systems to out-of-state retailers. For example, in Louisiana, sales taxes are collected not just at the state level but on a parish-by-parish basis, creating a complicated tax system for remote retailers to grapple with. Recognizing the issues with this system, Louisiana's legislature recently attempted to streamline the system through an eight-member commission.<sup>9</sup> However, despite passing the legislature with unanimous support, the streamlined system was narrowly rejected by voters because of questions regarding the effectiveness of the eight-member commission.<sup>10</sup> Unsurprisingly, following this rejection, a lawsuit was filed in district court by an out-of-state retailer challenging Louisiana's system of taxation as a "compliance nightmare" and an unconstitutional burden on interstate commerce.<sup>11</sup>

Similar to Louisiana, Colorado's sales tax system permits home-rule jurisdictions to impose their own sales taxes which may or may not be collected and remitted along with the state's sales tax,

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<sup>9</sup> Provides for the State and Local Streamlined Sales and Use Tax Commission, H.B. 199 (2021).

<sup>10</sup> Michael J. Bologna, *Louisiana Voters Reject Plan Overhauling Sales Tax Collections*, Bloomberg Tax (2021).

<sup>11</sup> See *Halstead Bead Inc. v. Lewis et. al.*, 2:2021cv02106 (Nov. 15, 2021).

depending on whether the home-rule jurisdiction has adopted an economic nexus standard and whether they participate in the state’s online “simplified” sales tax filing data base.<sup>12</sup> In addition—again, like their Louisiana counterparts—lawmakers in Colorado continue to try to simplify their state’s sales tax collection system which is viewed by many out-of-state retailers as a burden and a drain on business resources.<sup>13</sup>

## **II. The Expansion of Sales Tax Base**

### **A. Sales Tax Law**

Generally, states impose sales tax on the retail sales of tangible personal property and certain statutorily enumerated services. Recently, states have attempted to expand the sales or transactions that they subject to tax, i.e., the tax base. An example can be seen in New York State (“NYS”), where the Department of Taxation and Finance (“Department”) has aggressively targeted businesses that provide integrated services (or bundled transactions), i.e., services with multiple components, some of which may be taxable. The department has identified an individual component of the integrated service, ancillary to the overall purpose, which when viewed in isolation would be subject to sales tax. After identifying the taxable service, the Department proceeded to characterize the entire transaction as taxable. This alarming trend can be seen in the three cases discussed below. These decisions reject the Department’s expansion of the tax base and provide insight into the proper analysis of a bundled transaction.

### **B. Overview of Recent NYS Sales Tax Case Law Analyzing the Primary Function Test**

In *Matter of 1Life Healthcare, Inc.*, Div. Tax App. (Nov. 10, 2021), the Department attempted to subject a nontaxable bundled transaction to sales tax. 1Life Healthcare, Inc. (1Life) provides nonmedical, membership-based services to the patients of physician groups. The services, generally referred to as “care navigation services,” complement the physician groups’ provision of medical care and professional clinical services to their patients, and are generally meant to make the healthcare experience exceptional. The Department assessed 1Life, arguing that 1Life’s sales of annual memberships are subject to sales tax. The crux of the Department’s position was that 1Life members receive access to pre-written computer software (a mobile app and a web portal), which is taxable in NYS. 1Life’s chief argument was that its sales of memberships are nontaxable because the primary function is receiving nontaxable care navigation services, not taxable software. The mobile app and web portal are simply the means by which 1Life members are able to access the care navigation services.

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<sup>12</sup> Colorado Dept. of Revenue, *Colorado Tackles Sales Tax Simplification with Launch of Online Portal* (Nov. 13, 2020), <https://tax.colorado.gov/press-release/colorado-tackles-sales-tax-simplification-with-launch-of-online-portal>.

<sup>13</sup> Paul Williams, *Colo. Making Efforts to Lower Remote Seller Litigation Threat*, Law 360 (2022).

The administrative law judge (“ALJ”) determined that 1Life’s services were not subject to sales tax. Generally, NYS imposes sales tax on the retail sale of pre-written computer software (software that is not designed for a specific purchaser).<sup>14</sup> However, the ALJ found that the means by which a service is provided does not determine a service’s taxability<sup>15</sup>; rather, an integrated service must be taxed according to its primary function.<sup>16</sup> The ALJ ultimately agreed with 1Life, holding that the primary function of membership was receiving care navigation services, which are not statutorily enumerated services subject to tax.<sup>17</sup> The ALJ noted that the use of software to access care navigation services was merely one component of the overall service.<sup>18</sup> Further, the software was not integral for all patients because they regularly accessed services through other means.<sup>19</sup>

In *Matter of LendingTree Inc.*, Div. Tax App. (Dec. 09, 2021), the Department also assessed a bundled transaction. LendingTree Inc. operates an online loan marketplace that connects prospective borrowers seeking loans or other credit-based offerings with participating lenders. LendingTree’s online loan marketplace services match prospective borrowers with multiple lenders that provide them with competing quotes for the loans or other products they are seeking (matching services). LendingTree also provides advertising services (non-matching services) through the online loan marketplace. The Department assessed tax, penalties, and interest against LendingTree, on the grounds that all its services are taxable information services.

The ALJ turned to the primary function test to determine the taxability of LendingTree’s services. In NYS, the receipts from sales of information services are subject to sales tax.<sup>20</sup> Typically, “information services” include the “collecting, compiling, or analyzing of information of any kind...and furnishing reports thereof to other persons.”<sup>21</sup> The ALJ observed that an integrated service must be taxed according to its primary function.<sup>22</sup> To determine the primary function, the service must be reviewed in its entirety, rather than reviewing the components or the means in which the service is effectuated.<sup>23</sup> Although LendingTree furnishes prospective borrowers to matched lenders, the ALJ found that the primary function of the online loan marketplace services is to facilitate the writing of loans by LendingTree’s customers, i.e., its network of lenders.<sup>24</sup>

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<sup>14</sup> N.Y. Tax Law § 1105(a); N.Y. Tax Law § 1101 (b)(14).

<sup>15</sup> *Matter of 1Life Healthcare, Inc.*, Div. Tax App. (Nov. 10, 2021) (citing *Matter of SSOV '81 Ltd.*, Div. Tax App. (Jan. 19, 1995)) (In the interest of full disclosure, Pillsbury and Andersen represented the taxpayer in this case).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> N.Y. Tax Law § 1105(c)(1).

<sup>21</sup> *Id.*; 20 NYCCR 527.3(a).

<sup>22</sup> *Matter of LendingTree Inc.*, Div. Tax App. (Dec. 09, 2021) (citing *Matter of SSOV '81 Ltd.*, Div. Tax App. (Jan. 19, 1995)) (In the interest of full disclosure, Pillsbury represented the taxpayer in this case).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

*Matter of Breakdown Services Ltd.*, Div. Tax App. (Jan. 27, 2022) was the Department’s most recent attempt to expand the sales tax base using bundled transactions. Breakdown Services Ltd. connects casting directors with talent representatives across the United States. Breakdown’s service allows casting directors to post descriptions of available film and television acting roles on their website, and talent representatives to submit their actor clients for those roles. Casting directors can select actors for auditions, schedule auditions, and conduct auditions through Breakdown’s online platform. Talent representatives pay a fixed fee for the service, while casting directors do not pay anything. The Department assessed Breakdown on the grounds that the service sold to talent representatives was a taxable “information service.” The Department argued that the service was a taxable information service because talent representatives pay to obtain the acting role descriptions that casting directors post on Breakdown’s online platform.

The ALJ again rejected the Department’s approach to determine that Breakdown’s service was not subject to sales tax. In NYS, “information services” include “collecting, compiling, or analyzing information of any kind... and furnishing reports thereof to other persons.”<sup>25</sup> The ALJ noted that under NYS law, the taxability of an integrated service depends on its primary function.<sup>26</sup> The ALJ found that the primary function of Breakdown’s integrated service is to facilitate the casting of actors in acting roles, a nontaxable service.<sup>27</sup> In support, the ALJ stated that Breakdown was involved in every step of the casting process and was essential to the casting of actors in acting roles.<sup>28</sup> As a result, the ALJ found that the acting role descriptions posted on Breakdown’s online platform are simply how the service is provided, not its primary function.<sup>29</sup> Based on these findings, the ALJ canceled the department’s assessment.

These cases uniformly demonstrate that the proper analysis of a bundled transaction for NYS sales tax purposes requires the analysis of the primary function of the service provided. The Department’s attempts to expand the sales tax base by aggressively pursuing bundled transactions have been rejected by the ALJ decisions.

## **Conclusion**

These developments illustrate the states’ attempts to expand the reach of sales tax through both jurisdictional and tax base changes. States continue to subject more vendors to sales tax through both economic and physical presence nexus. In addition, states are also increasing the number of services and transactions, subject to tax.

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<sup>25</sup> N.Y. Tax Law § 1105(c)(1); 20 NYCCR 527.3(a).

<sup>26</sup> *Matter of Breakdown Services Ltd.*, Div. Tax App. (Jan. 27, 2022) (citing *Matter of SSOV '81 Ltd.*, Div. Tax App. (Jan. 19, 1995)) (In the interest of full disclosure, Pillsbury represented the taxpayer in this case).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

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