



BakerHostetler



OHIO SALES & USE TAX SIGNIFICANT DEVELOPMENTS

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AGENDA

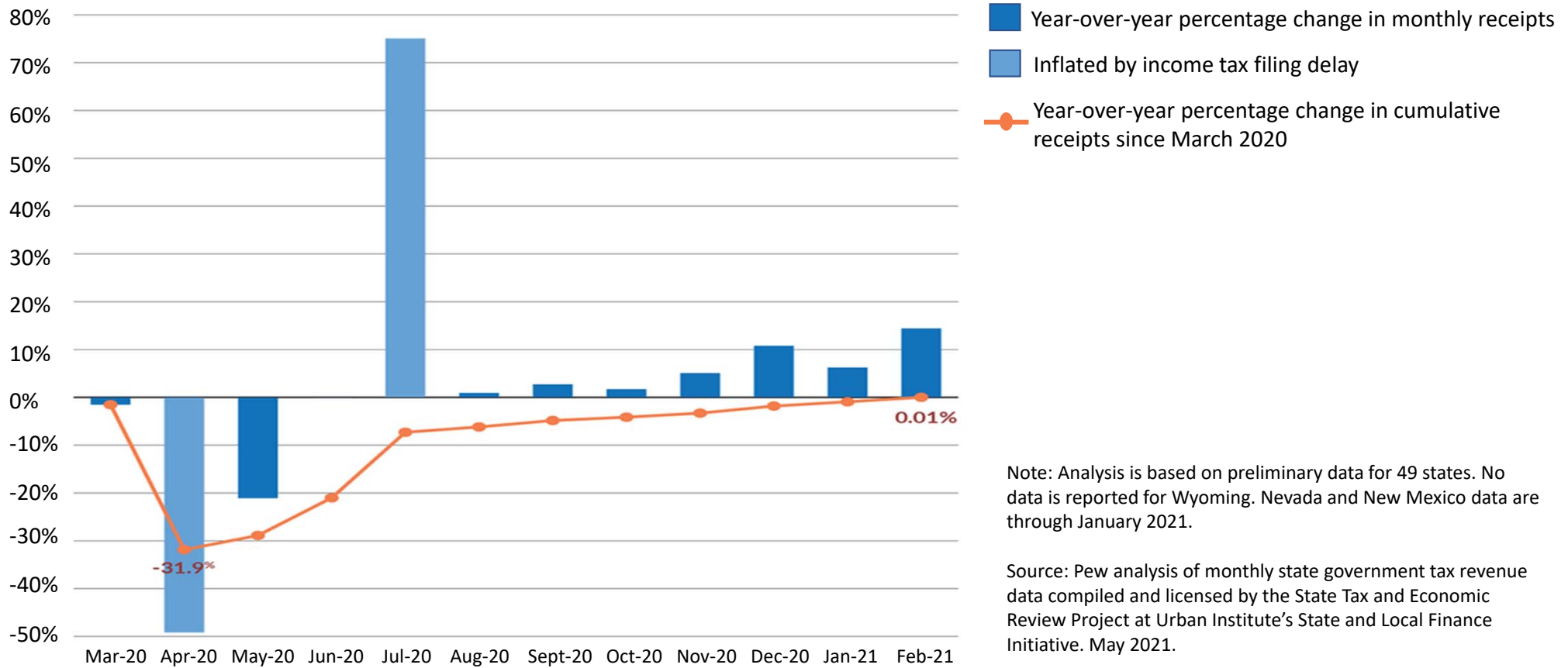
- Sales and use tax developments at the national level.
- Audits
- Expanding taxes on digital products and services.



NATIONAL SALES AND USE TAX DEVELOPMENTS

State Tax Revenues Overcomes Early Pandemic Losses

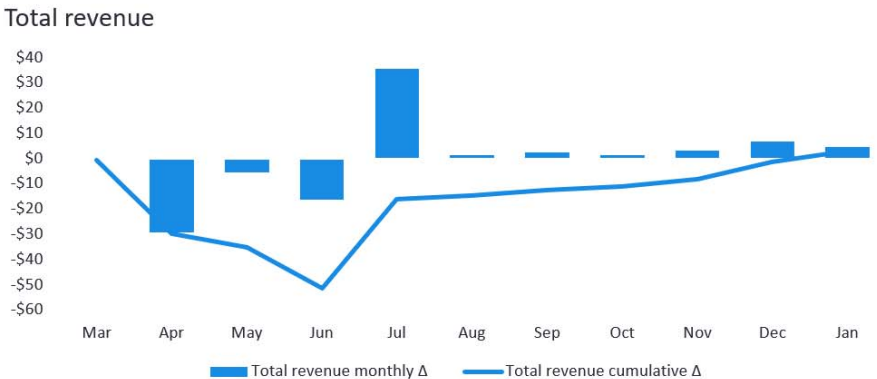
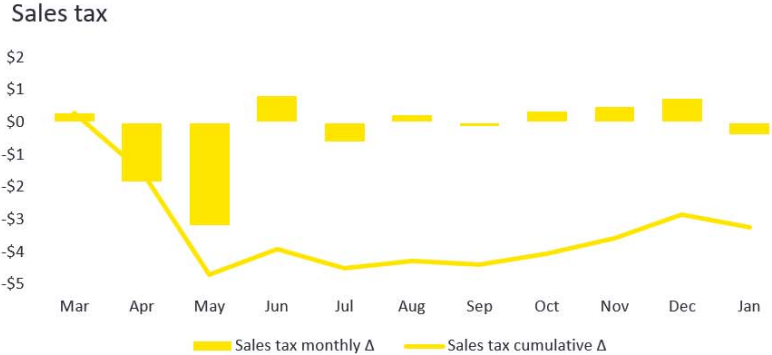
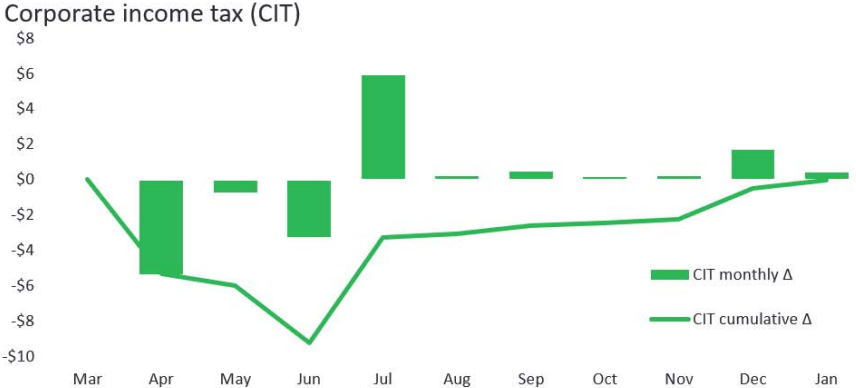
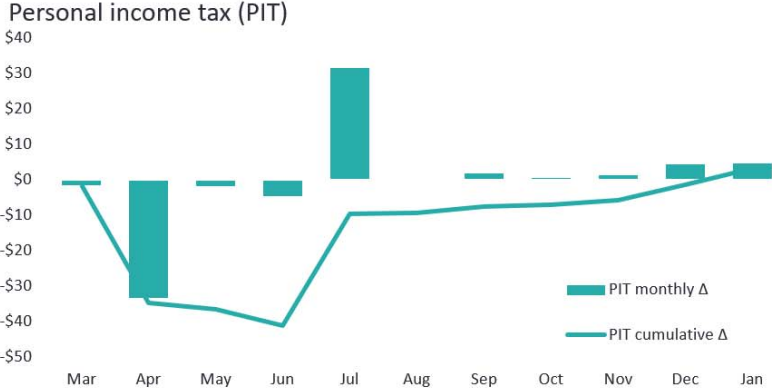
How monthly and cumulative receipts compare with totals from a year earlier



Note: Analysis is based on preliminary data for 49 states. No data is reported for Wyoming. Nevada and New Mexico data are through January 2021.

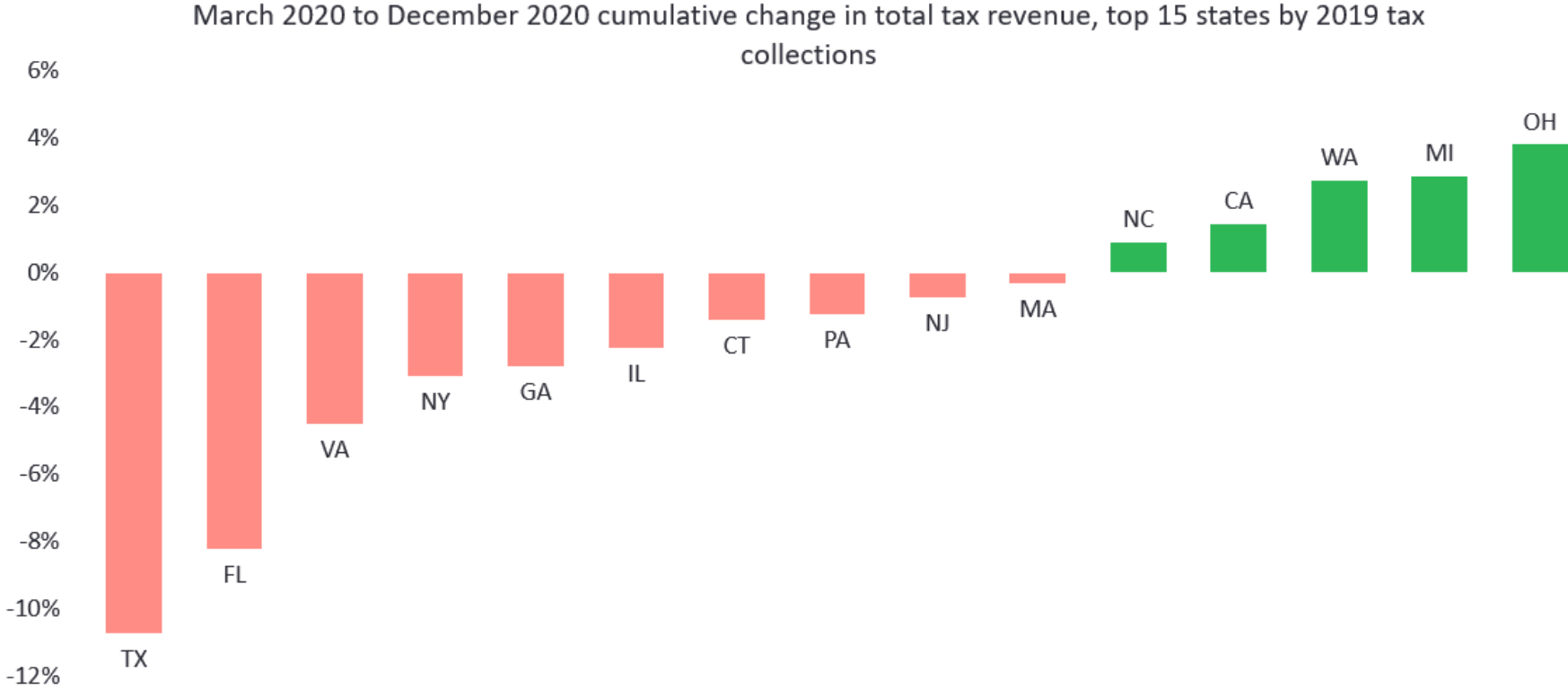
Source: Pew analysis of monthly state government tax revenue data compiled and licensed by the State Tax and Economic Review Project at Urban Institute's State and Local Finance Initiative. May 2021.

State Taxes Have Surpassed Initial Negative Pandemic Fiscal Outlook



Source: EY calculations based on state monthly tax collection reports, top 15 states ranked by 2019 tax collections.

Cumulative Tax Collection Changes March-December 2020



Source: EY calculations based on state monthly tax collection reports, top 15 states ranked by 2019 tax collections.



**Economic Presence & Marketplace
Laws – Law of the Land for Sales
Tax States**



Issues with Economic Presence Laws

- Most states use \$100k or 200 transactions
 - How calculated – gross, retail, or taxable?
 - Some states have higher threshold (AL - \$250k, CA - \$500k, MS - \$250k, and TX - \$500k)
 - Measurement period – current, current and/or preceding year, trailing nexus
 - Some states exclude services in calculation – *e.g.*, California & Georgia



Pre-Wayfair Issues Still Pending

- **California** is looking at sellers with inventory in the State that used facilitators to sell their products
 - Lawsuit filed against CDTFA in federal district court in IL stating facilitators should have collected tax (*Rubinas v. Maduros*)
- **Massachusetts** asserting its “cookie nexus” rule eff. 10/1/2017
- **South Carolina** Department of Revenue asserting marketplace seller collection back to 2016, prior to state enacting such a law in 2019
 - *Amazon Services v. SC Dep’t of Revenue*
 - SC A.G. has attempted to get *amicus* briefs dismissed as not being relevant

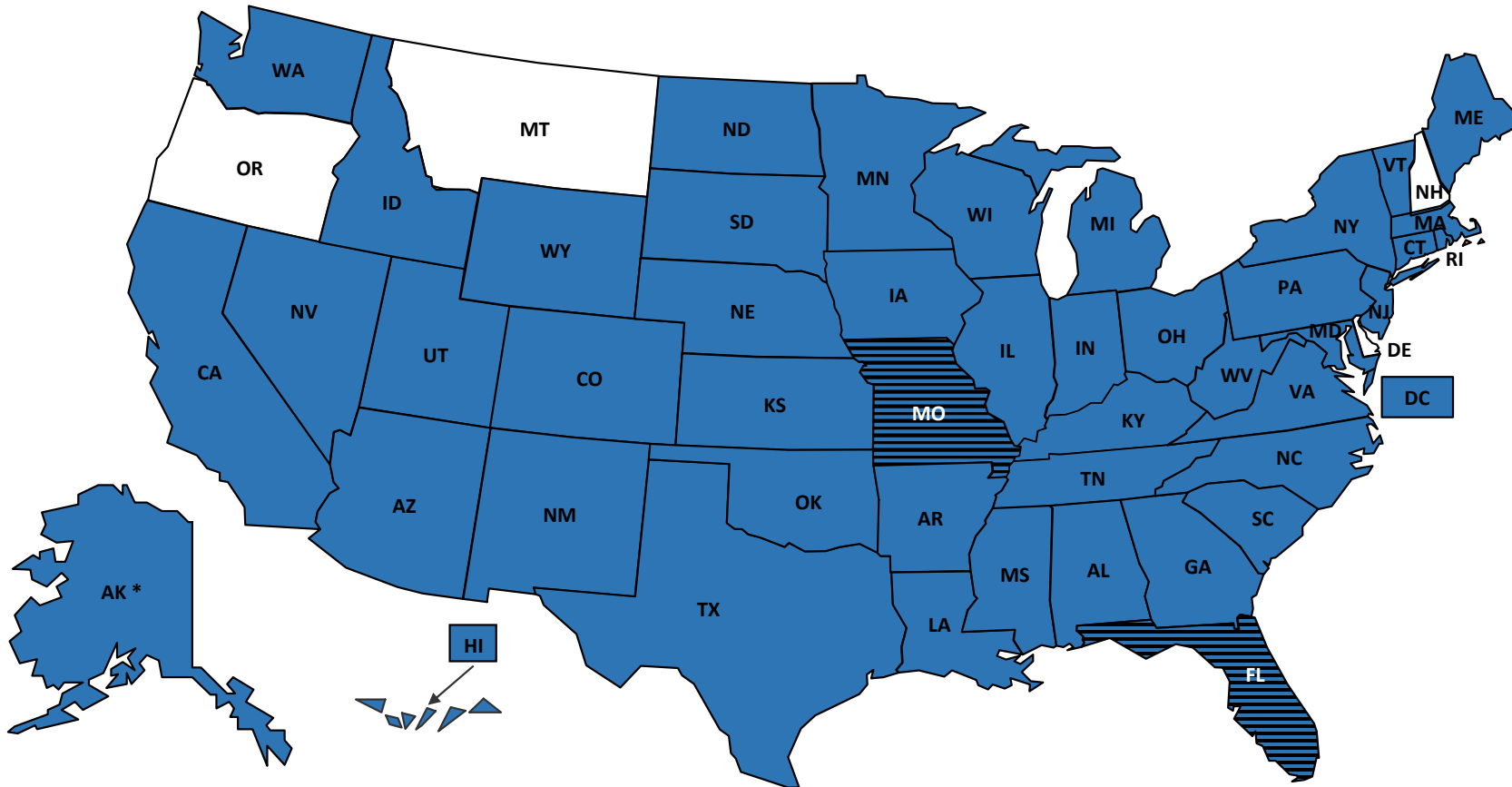


Post-*Wayfair* Issues

- **New Hampshire** – a state without a sales tax enacted legislation, S.B. 242, to allow the State’s Department of Justice to determine if another state’s law:
 - Provides a safe harbor to NH businesses that conduct limited business in the state; and
 - Provides a deduction or reimbursement to NH sellers for their cost to collect the state’s sales taxes.
- **U.S. Government Accountability Office (GAO)** asked to update study on *Wayfair*’s impact on small businesses
- **Uniformity - Streamlined Sales Tax State** – Generally, most sales tax states followed 2 out of 3 features SCOTUS noted with South Dakota’s law in *Wayfair*. The states 1) have not applied an economic nexus requirement retroactively and 2) have a small business exception (KS enacted this year). However, a third feature noted by SCOTUS was South Dakota being an SSUTA state and it having uniform laws with other states. No additional states, thus far, has joined the SSUTA to address this feature.
 - Alaska, Colorado, and Louisiana are working on their local tax burdens

State Adoption of Marketplace Facilitator Laws

■ States with marketplace facilitator laws ■ States that enacted this year □ States with no sales tax



* = Alaska has no state sales tax, based on Alaska Remote Seller Sales Tax Commission Uniform Code



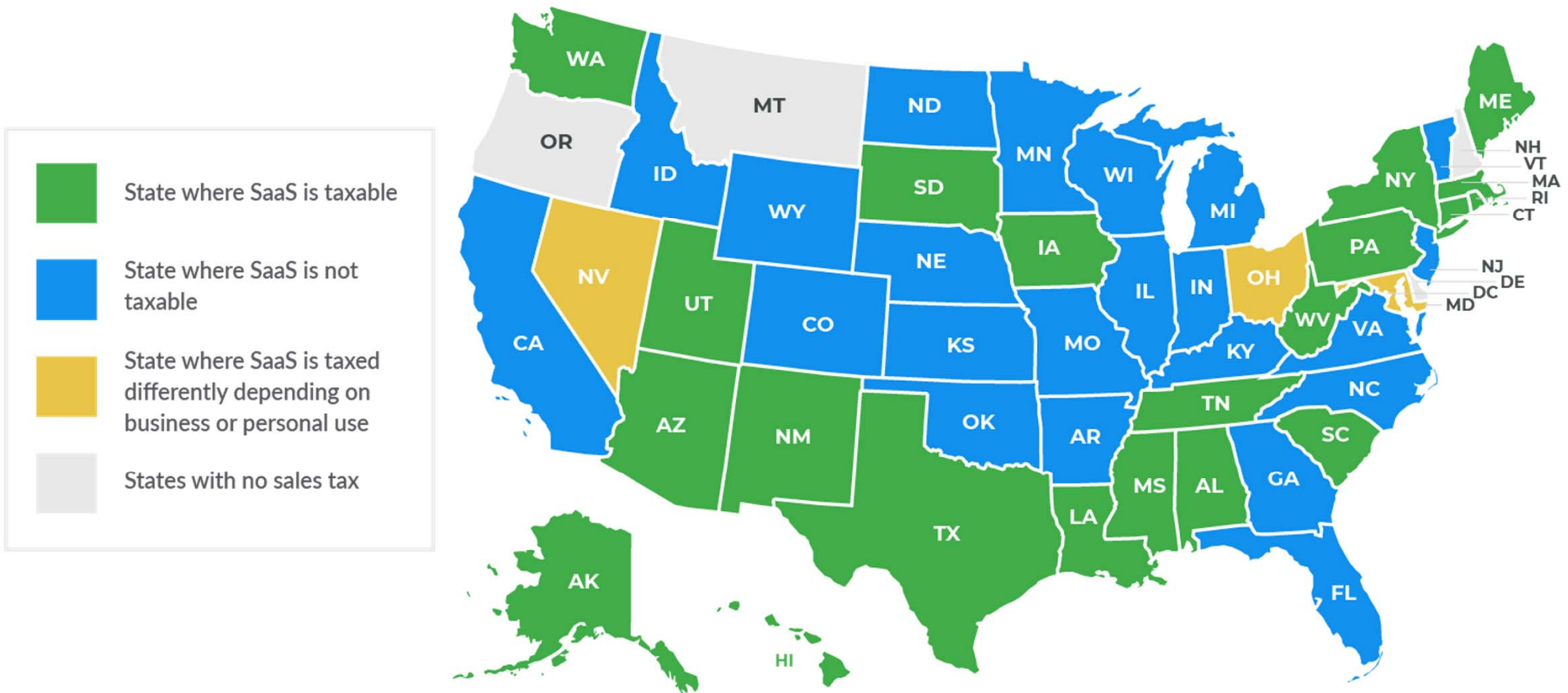
Issues with Marketplace Laws

- While the NCSL adopted model legislation, most states use ad hoc variations
 - Breadth of definition of who is a facilitator
 - Marketplace seller waivers if substantially all marketplace sellers collect or for a marketplace seller that already collects tax in every state
- How will exemptions apply
- How will coupons apply
 - Can marketplace facilitator use marketplace seller coupon to reduce price?
 - Ohio coupon rule – 5703-9-15 – does not directly address but COST raised issue with purchased coupons/vouchers
- Refunds, vendor discounts & Bad Debt (IRC § 166)
- Collection of other taxes and fees
 - States, *e.g.*, Georgia, pushing for local lodging taxes not filed with a sales tax return



States Taxing Software as a Service (SaaS) Continues to Grow

States Taxing Software as a Service (SaaS)



Source: Tax Jar (March, 2021)

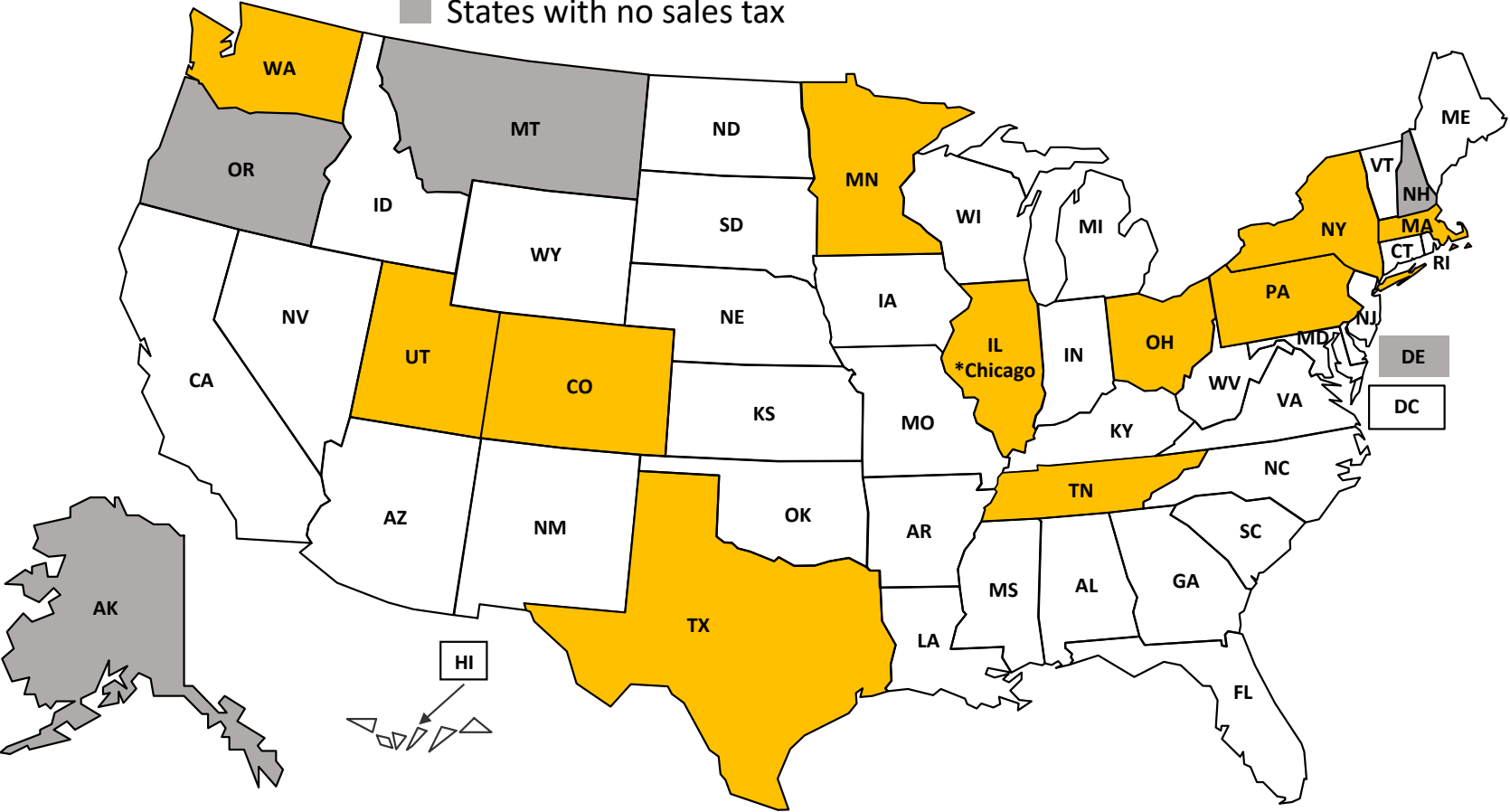


Issues with SaaS

- There are no uniform definitions in the SSUTA addressing SaaS (software not actually delivered to a customer, but merely accessed)
- Some states tax it as a service while others try to carve it into its tangible personal property definition (*e.g.*, pending legislation in Colorado)
- Sourcing issues and many states do not have Multiple Points of Use (MPU) provisions
 - Massachusetts' Supreme Judicial Court recently held in *Oracle USA v. Comm. Of Revenue* (5/21/21), that a seller did not have to comply with a rule requiring MPU claim to be made prior to filing of tax return
- Some states do not have clear imposition statutes, using administrative provisions: AZ, CT, IL, MA, NM, NY, and TX (source: COST 2018 Scorecard – update in process)
- MTC is broadly looking at a white paper addressing how states are taxing certain digital products

States Allowing Apportionment of Software

- State with an apportionment process for software used in multiple jurisdictions
- States with no sales tax



Source: COST Preliminary review of states' laws for upcoming 2021 Sales Tax Systems Scorecard



**Retail Sale of Built-In Appliances
With Installation – Retail Sale or
Construction Contract?**



Issues with Appliance Installation

- Most states treat a contractor as the “purchaser” when the property purchased is incorporated into real property. Thus, the cost of the materials is taxable, however, the labor to install the property is not subject to tax.
- Several retailers both sell appliances and offer installation contracts when an appliance is purchased that will be incorporated into real property (*e.g.*, dishwashers, wall ovens, cabinets, etc.).
 - Generally, tax collected on sales price when no installation is provided, and no tax collected from purchaser when installation is provided (retailer owes tax on its purchase price of an appliance)
 - *E.g.*, retail sales price \$1,000 versus seller’s purchase price of \$600
- **Illinois** – *Best Buy v. IL DOR* (6/30/20) – IL appellate court held tax was owed on appliances sold with an installation contract based on purchaser’s sales price and not seller’s purchase price. Court did not believe appliances were “permanently affixed” and the “substance” of the transaction was Best Buy acting as a retailer.
- **South Carolina** – *Lowe’s Home Centers v. SC DOR* – Lowe’s assessed \$2.9 million in sales tax for materials used in improvement contracts. SC DOR apparently shifted its position, and the case is pending before the SC Court of Appeals. The DOR assessed the taxpayer for sales tax based on marking the materials/goods up by 40 percent from the taxpayer’s purchase price (DOR’s estimate of the retailer’s margin).



AUDITS



MULTISTATE TRENDS

- ▶ Audit Activity
 - ▶ Ohio
 - ▶ Kentucky
 - ▶ New York
- ▶ Economic Nexus
 - ▶ Wisconsin
 - ▶ Massachusetts
 - ▶ Maine
- ▶ Third party audits
 - ▶ Parishes in Louisiana
 - ▶ Alabama locals



AUDIT SELECTION

- ▶ “Big Data” / Data Analytics
 - ▶ Business profiles and comparisons
 - ▶ Taxpayer maintains accounts with \$0 remittances, especially use tax
 - ▶ Taxpayer maintains other tax accounts (withholding, etc.)
 - ▶ IRS and other U.S. government agencies (individual use tax)
- ▶ Direct Pay Permit holders
- ▶ Size of company
- ▶ Audit history
- ▶ Current hot topics (industry types, court cases or new laws)



AUDIT PROCESS

- ▶ Remember, auditor is doing their job
- ▶ Treat auditor with respect
- ▶ Personality conflicts do arise
- ▶ May request meeting with auditor's manager
- ▶ Get auditor to commit to time frame for completion and monitor progress
- ▶ Limit, not prohibit, auditor's access to records and personnel
- ▶ Auditor requests should go through one designated person
- ▶ Sign Waiver of Statute only if beneficial to taxpayer



AUDIT PREPARATION

- ▶ Complete exposure and overpayment analysis prior to audit
- ▶ Overpayment amounts can reduce assessment liability
- ▶ Do not rely on auditor to identify or calculate refunds
- ▶ Importance of records
- ▶ “Audit ready” files
- ▶ Preparation allows for quick turn around of information requests



INFORMATION REQUESTS

- ▶ Request is almost always “boilerplate”
- ▶ Discuss scope of audit with auditor first
- ▶ Reviewing sales, purchases or both? Attempt to eliminate sales where possible
- ▶ Consider what is actually needed to begin and complete the audit
- ▶ Income tax returns, organizational charts and other information not relevant to a sales/use tax audit



SAMPLING

- ▶ Methodologies
 - ▶ Block Sample
 - ▶ Stratified Statistical Sample
 - ▶ Comprehensive
- ▶ May be used for sales or use tax audits
- ▶ Benefits of sampling
 - ▶ Fewer records to pull
 - ▶ Auditor spends less time on site
- ▶ Auditors sometimes push block samples
- ▶ Recommend stratified statistical sample where feasible



SAMPLING

- ▶ Practical Considerations:
 - ▶ Statistical sample is most representative
 - ▶ Seasonality of business
 - ▶ Large, non-recurring transactions
 - ▶ Certain transactions should be pulled out into separate “audit measure”
 - ▶ Leases
 - ▶ Natural Gas
 - ▶ Availability of data (Accounting system changes?)
 - ▶ May be easier to obtain records for block sample
 - ▶ Customer bill back considerations for sales tax audits



AUDIT ISSUES

- ▶ Temporary employment services
- ▶ Manufacturing exemption – “Point of Commitment”
- ▶ Business fixtures – tangible property versus real property
- ▶ Software and other technology purchases
- ▶ Electronic information services
- ▶ Automatic data processing services
- ▶ Application of R&D exemption
- ▶ Advertising services
- ▶ Building maintenance and cleaning services
- ▶ Landscaping and snow removal



AUDIT ISSUES

- ▶ Documentation
 - ▶ Missing invoices
 - ▶ Purchase cards
- ▶ Knowledge level of auditors / Manager involvement
- ▶ Strict adherence to processes
- ▶ Business operations / Industry experience
- ▶ Importance of preparation for plant tours



INTEREST AND PENALTY

- ▶ Interest
 - ▶ Federal short term rate plus 3%
 - ▶ 2021 – 3%
 - ▶ Statutory
- ▶ Penalty
 - ▶ Maximum of 15% except for failure to remit sales tax
 - ▶ Discretionary
 - ▶ Penalty Review Committee within Department
 - ▶ Recognize compliance
 - ▶ Attempt at consistency



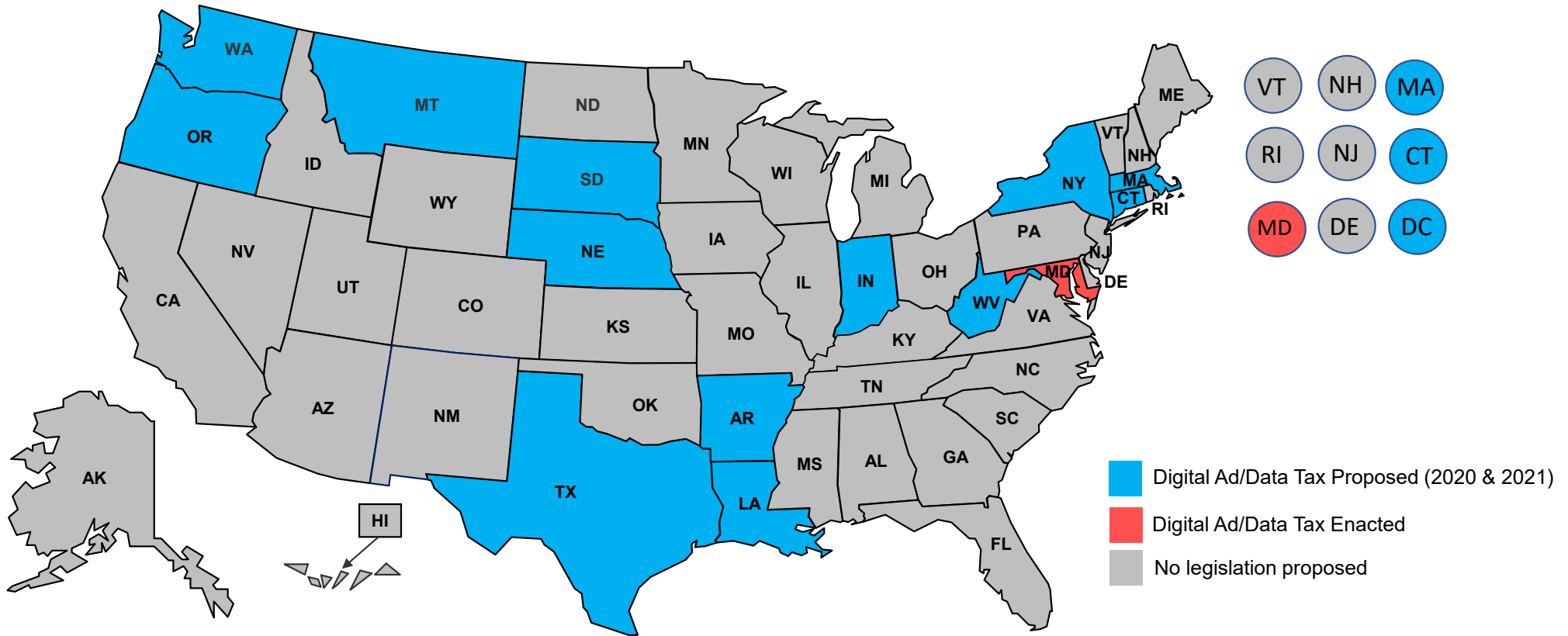
TAXATION OF DIGITAL PRODUCTS AND SERVICES



WHAT ARE WE TALKING ABOUT?

- ▶ Tax on digital products
- ▶ Tax on digital services
- ▶ Tax on digital advertising services
- ▶ Tax on collection of consumer data

2020 & 2021 Digital Advertising Services & Data Tax Proposals



Disclaimer: This information should be used for general guidance and not relied upon for compliance.
Source: Council On State Taxation



DIGITAL PRODUCTS

- ▶ Some states expressly impose tax on digital products. Here is the Ohio definition in R.C. 5739.01
- ▶ (QQQ) "Specified digital product" means an electronically transferred digital audiovisual work, digital audio work, or digital book.
- ▶ (1) "Digital audiovisual work" means a series of related images that, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.
- ▶ (2) "Digital audio work" means a work that results from the fixation of a series of musical, spoken, or other sounds, including digitized sound files that are downloaded onto a device and that may be used to alert the customer with respect to a communication.
- ▶ (3) "Digital book" means a work that is generally recognized in the ordinary and usual sense as a book.
- ▶ (4) "Electronically transferred" means obtained by the purchaser by means other than tangible storage media.



DIGITAL PRODUCTS AS TANGIBLE PERSONAL PROPERTY

- ▶ Some state deem digital products to be tangible personal property.
- ▶ It is said that the method of delivery does not matter and includes audio visual and other items delivered by:
 - Compact disc
 - Electronic download
 - Internet streaming
 - Other methods not yet developed?



DIGITAL SERVICES

- ▶ Not really an easily distinguishable separate category of something “digital,” but there are examples:
 - Automatic data processing such as Ohio and Texas
 - Electronic information services in Ohio
 - Digital publishing services in Ohio
 - Cloud computing
 - Streaming services

Some of these are taxed as tangible personal property, digital products, telecommunication services or other types of taxes.



TAXING SERVICES DELIVERED ELECTRONICALLY

Traditional services may become “taxable” when electronic means are used to provide the service.

In *Dayton Physicians, LLC. v. Testa*, Montgomery App. No. 26881, 2016-Ohio-5348, a medical transcriptionist providing a verbatim electronic transcription of medical notes was found to be subject to tax as providing an automatic data processing service. Contrast this with obtaining a transcript of a hearing at the Ohio Board of Tax Appeals that would not be taxable. The computer is simply the means of delivery.



DIGITAL ADVERTISING SERVICES TAXES

This is perhaps the hottest area of state and local and international taxation.

- ▶ Numerous states have considered these taxes.
- ▶ Several major cases are challenging the tax enacted in Maryland.
- ▶ While some of these taxes are not sales taxes, some are and all these taxes began as sales taxes.



MOTIVATIONS FOR TAXES ON DIGITAL ADS

- ▶ Seems to be directed at big, world-wide technology platforms like Google and Facebook.
- ▶ Seems to be a reaction to the ability of the major tech companies to profit from data collected from customers.

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TAXING DIGITAL ADVERTISING

Ohio provides a specific exemption for digital advertising services defined in R.C. 5739.01 as follows:

(RRR) "Digital advertising services" means providing access, by means of telecommunications equipment, to computer equipment that is used to enter, upload, download, review, manipulate, store, add, or delete data for the purpose of electronically displaying, delivering, placing, or transferring promotional advertisements to potential customers about products or services or about industry or business brands.



DIGITAL ADVERTISING SERVICES TAX

The Ohio exemption for digital advertising services was enacted in 2016 in response to efforts by the Ohio Tax Commissioner to assess electronic billboards to advertise automobiles and other items as taxable electronic information services.



MARYLAND

- ▶ On March 18, 2020, the Maryland General Assembly passed House Bill 732.
- ▶ The Governor vetoed the bill but that veto was overridden.
- ▶ Tax became effective February 12, 2021 but the imposition of the tax likely will be delayed until 2022.



MARYLAND

- ▶ The tax is levied on any business that satisfies two criteria:
 - \$1 million or more of annual gross revenue from digital advertising services in Maryland; and
 - \$100 million or more of *worldwide* annual gross revenue (not just advertising).



MARYLAND

- ▶ “Digital advertising services” includes advertising services;
 - on a “digital interface”



MARYLAND

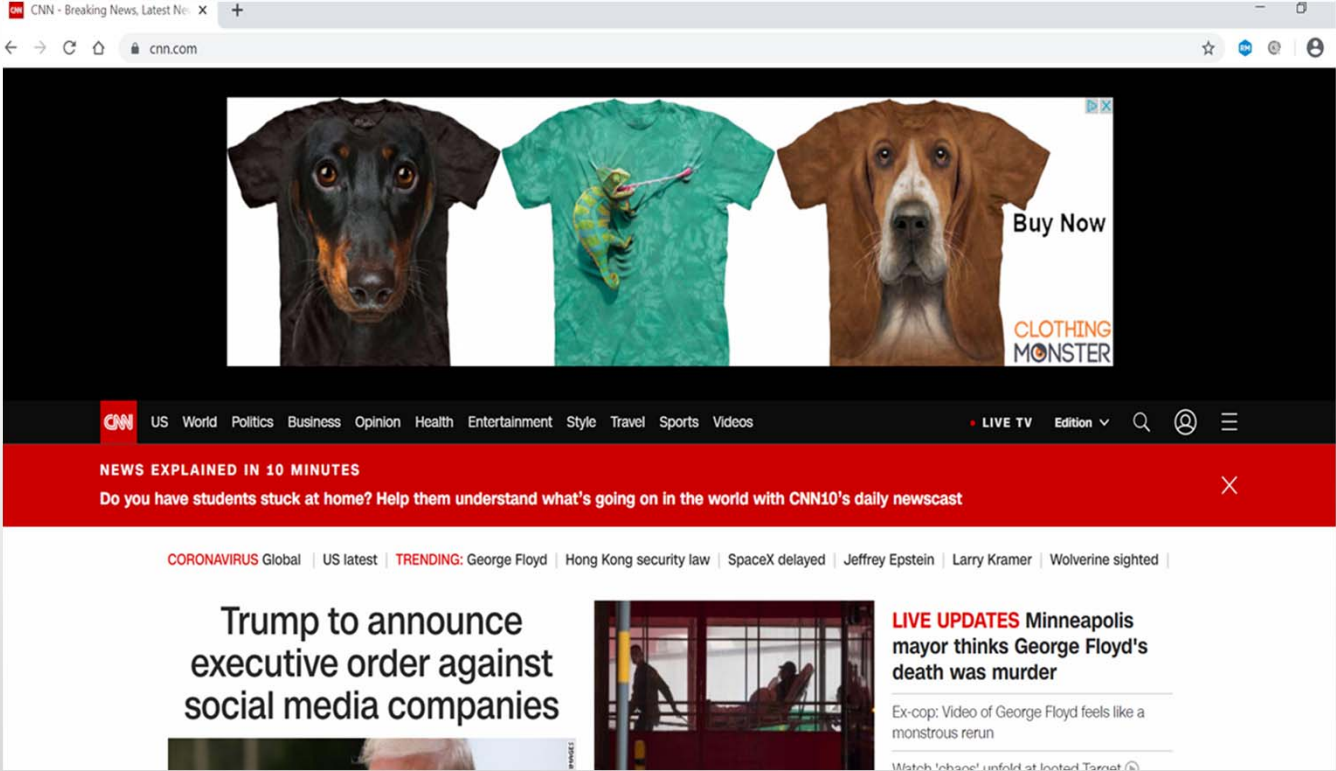
- in the form of:
 - banner advertising,
 - search engine advertising,
 - interstitial advertising, and
 - other comparable advertising services.



MARYLAND

- ▶ “Digital interface” means “any type of software including a website, part of a website or application, that a user is able to access.
- ▶ “User” means an individual or any other persons who accesses a digital interface with a device.
- ▶ The types of digital advertising to be taxed are not defined. Likely examples appear on the following slides.

BANNER ADVERTISING



The screenshot shows a browser window with the URL cnn.com. The main banner advertisement features three t-shirts: a black one with a Doberman's face, a green one with a chameleon, and a brown one with a Beagle's face. The text "Buy Now" and "CLOTHING MONSTER" is visible on the right side of the banner. Below the banner is the CNN navigation bar with links for US, World, Politics, Business, Opinion, Health, Entertainment, Style, Travel, Sports, and Videos. A red banner below the navigation bar reads "NEWS EXPLAINED IN 10 MINUTES" and "Do you have students stuck at home? Help them understand what's going on in the world with CNN10's daily newscast". Below this is a trending section with links for "CORONAVIRUS Global", "US latest", "TRENDING: George Floyd", "Hong Kong security law", "SpaceX delayed", "Jeffrey Epstein", "Larry Kramer", and "Wolverine sighted". The main content area features a large headline "Trump to announce executive order against social media companies" with a small image of Donald Trump. To the right is a "LIVE UPDATES" section for "Minneapolis mayor thinks George Floyd's death was murder" with a small image of a person in a cell and a sub-headline "Ex-cop: Video of George Floyd feels like a monstrous rerun".

SEARCH ENGINE ADVERTISING

Google

All Shopping Images Maps News More Settings Tools

About 1,910,000,000 results (0.66 seconds)

Ad · www.wayfair.com/

Wayfair Outdoor Furniture Sale | Save Up to 70% Off Top Brands
 Free Shipping on Orders Over \$35. Shop Furniture, Home Décor, Cookware & More! Free Shipping on All Orders Over \$35. Shop Furniture, Lighting, Storage & More! Great Ways to Save. Home Decorating Ideas. 2-Day Shipping. Home Improvement. Over 7 Million Items.
 ★★★★★ Rating for wayfair.com: 4.6 - Average delivery time: 1–5 days

Outdoor Furniture
 Outdoor Tables & Chairs at Wayfair
 Save Up To 70% at Wayfair Today!

Patio & Garden
 Shop Patio & Garden Furniture
 Find Outdoor Rugs, Lights, & More!

Ad · www.valuecityfurniture.com/

Value City Furniture® | Patio Furniture | ValueCityFurniture.com
 Didn't Get To Shop The 20% Memorial Day Sale? You Still Have Time! Shop Now Through 6/1. Find Your Happy Place That's Comfy For The Day To Day But Chic Enough For...
 Contact Us · Track Your Order · Find A Store Near You · Products On Sale · About Us

Ad · www.birchlane.com/

Well-Made Outdoor Furniture | Farmhouse, Rustic, and More
 Well-Made Furniture & Decor from Birch Lane®: Inspiration for a Classic Home. High-Quality...

See Patio furniture Sponsored

 Breccan Patio Furniture on... \$879.99 Wayfair Free shipping	 Rhymer 4 Piece Rattan Sofa Seatin... \$669.99 Wayfair ★★★★★ (10)	 Hampton Bay Park Lane 6-Piece Wick... \$299.00 \$449 Home Depot ★★★★★ (27)
 Cayman Outdoor Lounge Chair with... \$734.00 \$1,049 Crate and Barrel ★★★★★ (4)	 Steward Outdoor 3 Piece Rattan... \$459.99 Wayfair ★★★★★ (23)	 Flash Furniture JJ-S351-GG Aransas... \$396.49 WebstaurantStor...

Map: Rocky River, Madison Ave, The Home Depot

INTERSTITIAL ADVERTISING

The image shows a screenshot of a YouTube video player. At the top, the YouTube logo and a search bar containing the text "how to cut your own hair" are visible. The video content shows a man in a suit sitting at a desk in an office, holding a tomato. In the background, there is a skeleton model, a world map, and a bookshelf. An interstitial advertisement is overlaid on the bottom left of the video frame. The ad features a small profile picture of the man, the text "Total Restore" and "thegutrenewal.com", and a blue "Next Step" button. Below the video frame, the video title "Easiest Self-haircut 2020 | How to Cut Your Own Hair" is displayed, along with "442,784 views · May 9, 2020". At the bottom right, there are icons for likes (9.6K), comments (144), share, save, and a menu icon.



MARYLAND

- ▶ Tax rates range from 2.5% to 10% of a business's annual gross revenue from digital advertising services in Maryland.
- ▶ Note that the rates are determined not by Maryland revenues and not by digital revenue but by worldwide gross revenue.
- ▶ Businesses with less than \$100 million in annual gross revenue or less than \$1 million in annual gross revenue from Maryland digital advertising services are exempt.



MARYLAND

- The tax rates apply as follows:
 - 2.5% for companies with annual worldwide gross revenues of \$100 million through \$1 billion;
 - 5% for companies with annual worldwide gross revenues above \$1 billion through \$5 billion;
 - 7.5% for companies with annual worldwide gross revenues above \$5 billion through \$15 billion; and
 - 10% for companies with annual gross worldwide revenues above \$15 billion.



MARYLAND

Sourcing

- The legislation provides little guidance on what portion of total digital ad revenue is sourced to Maryland.
- The Maryland Comptroller is charged with interpreting and establishing the sourcing rules.



MARYLAND

- ▶ Requires an annual return on April 15
- ▶ Requires quarterly estimated taxes.
- ▶ The new digital ad tax presumably will take effect in 2022.
- ▶ Now exempts broadcast entities
- ▶ Taxpayers cannot pass through the tax



LEGAL CHALLENGES

- ▶ There are several legal challenges to the Maryland tax that are pending based on:
 - Internet Tax Freedom Act
 - Commerce Clause
 - Foreign Commerce Clause
 - First Amendment as a targeted tax
 - Due Process



BUSINESS RESPONSE TO DIGITAL ADVERTISING TAXES

COST and other business groups oppose the enactment of the digital service taxes.



OTHER STATE TAXES ON DIGITAL ADVERTISING

- ▶ Several other states are considering imposing tax on digital advertising including:
 - Arkansas
 - Connecticut
 - Massachusetts
 - Montana
 - Nebraska
 - New York
 - Texas
 - West Virginia



HOW DOES DIGITAL ADVERTISING ACTUALLY WORK?

The following slides portray how digital advertising is sold.

STEP 1: PAGE STARTS LOADING





AD AUCTIONS

Auctions Occur Every Page Load

Websites Sell Space

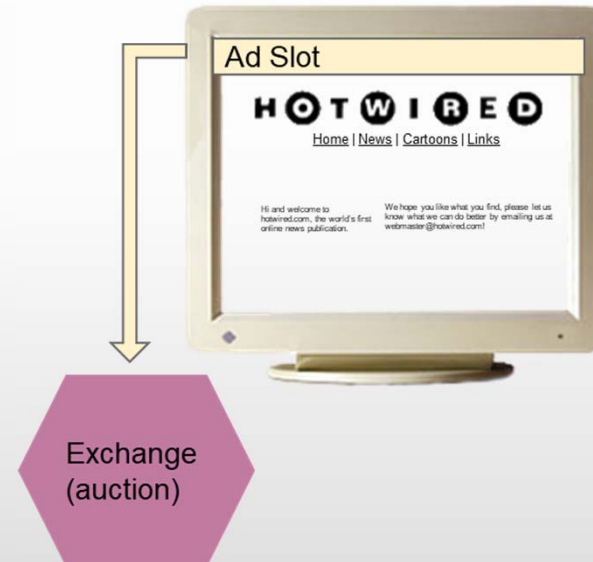
Advertisers Bid

Exchanges Handle Logistics

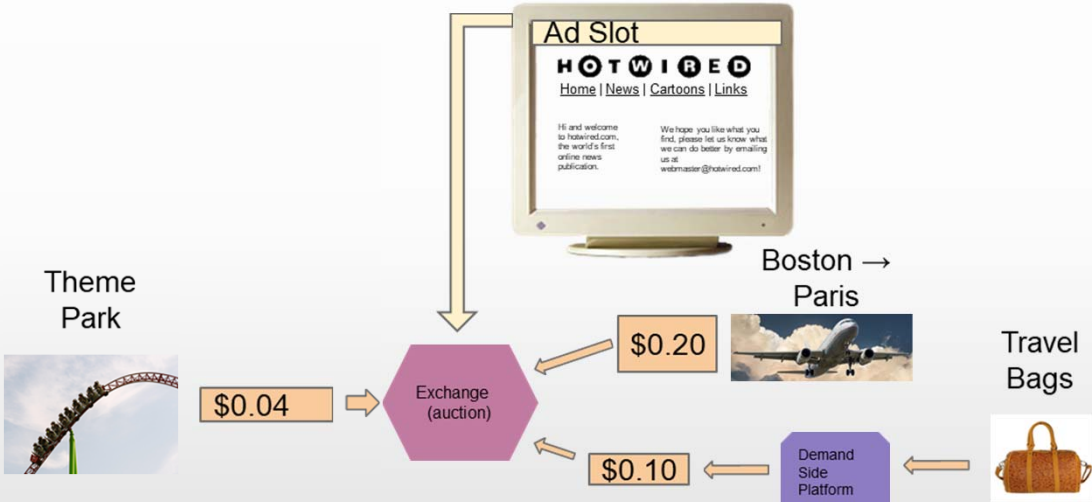
STEP 2: AD SLOT “ASKS” FOR AD

Ad request sent with
Device-Identifiable
Information, such as:

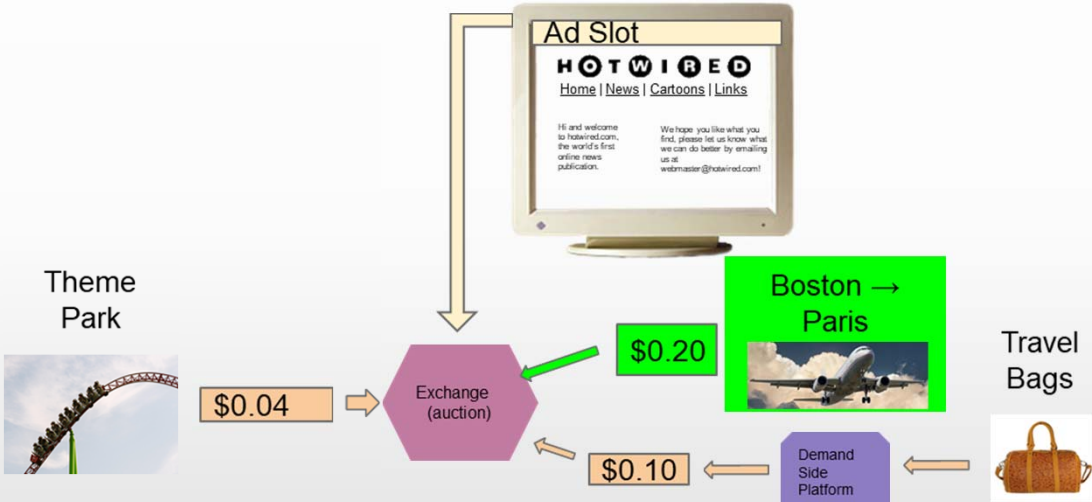
- IP address: 12.12.1.1
(*Boston*)
- Cookie ID: 12345
(*Frequent Traveler*)
- Site: hotwired.com



STEP 3. ADVERTISERS BID



4. WINNER IS PICKED

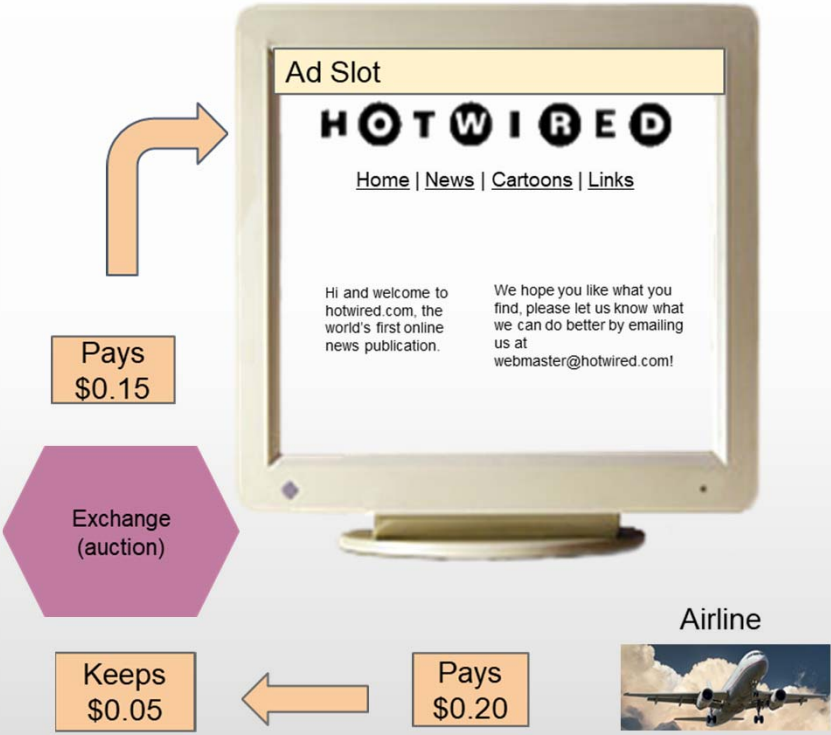


STEP 5: AD DELIVERED



Time Elapsed:
0.35 seconds

STEP 6: PAYMENT SETTLED





NEW YORK TAX ON COLLECTING DATA

- ▶ New York is proposing a new kind of tax on collecting data
- ▶ It is a head tax measured by the number of New York consumers on which the taxpayer collects data.
- ▶ If data is collected on fewer than 1 million New Yorkers, there would be no tax.
- ▶ The rates increased based on total volume of residents whose data is being collected from .05 to \$.50 per consumer.



NEW YORK TAX ON COLLECTING DATA

- ▶ The “commercial data collector” is one which collects, maintains, uses, processes, sells or shares consumer data in support of its business activities.
- ▶ A “consumer” is an individual who purchases goods or services or uses the services of other commercial data collectors whether charged for those service are not.
- ▶ “Consumer data” is defined broadly to including any information that identifies, relates to, describe, is capable of being associated with, or could reasonably be aligned with a consumer, whether directly submitted to the commercial data collector by the consumer or derived from other sources.



NEW YORK TAX ON COLLECTING DATA

- ▶ Serious concerns about the tax
 - Tracking information
 - Privacy of the consumer
 - Preventing double counting
 - Hidden tax
 - Tax on business inputs



MTC EVALUATING DIGITAL TAXES

The Multistate Tax Commission intends to examine how the states tax digital products and services.



SUMMARY

- ▶ This summary comes from an article written by Natalia Garrett, Deputy Assistant Director, Audit District and Grant Nulle, Deputy Director, both of the Arizona Department of Revenue in *Digital Goods and Services: How States Define, Tax and Exempt These Items*, published in *Tax Notes State*, May 18, 2020.

“How do the states define, tax and exempt from taxation digital goods and services? Each and every way. The end.”