Bloomberg Tax

Daily Tax Report®

Reproduced with permission from Daily Tax Report, 211 DTR 13, 11/1/19. Copyright © 2019 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com

INSIGHT: M&A Due Diligence Checklist Post-Wayfair

BY JENNIFER WEIDLER KARPCHUK

During June 2018, the U.S. Supreme Court upended 50 years of precedent when it ruled in favor of the state in *South Dakota v. Wayfair, Inc.*

From 1967 through 2018, in order for a state to subject a taxpayer to sales and use tax collection, it was required to have a physical presence in the taxing state. As the economy and conduct of business evolved over the years, states consistently tried to erode the physical presence standard and finally succeeded with a win in *Wayfair*. In *Wayfair*, the U.S. Supreme Court upheld South Dakota's economic nexus standard which imposed a sales tax collection obligation on remote sellers whose only connection with the state was sales into the state exceeding $100,000 or 200 transactions annually.

While some constitutional limits still apply to a state's ability to impose its taxes upon out-of-state companies, there is no bright line rule that taxpayers can rely upon. The lack of bright line tests means that application of *Wayfair* to state and local jurisdictions throughout the country will inevitably unravel nuances and expanded nexus where it may not be anticipated. This particularly becomes an issue in the realm of mergers and acquisitions, heightening the discrepancy between liability assessments between buyers and sellers—with some buyers wishing to be overly cautious, thereby driving up their calculation of contingent liabilities. **Since the Wayfair decision created expanded nexus and will continue to result in varied approaches by the states, it is imperative that buyers and sellers fully consider the potential impact of the decision during due diligence to ensure all potential liabilities are thoroughly assessed and addressed before closing.** This Checklist highlights some key issues to be aware of affecting mergers and acquisitions and due diligence post-*Wayfair*:

■ Ensure there are no unpaid taxes of a target corporation.

Comment: Sales and use taxes are the obvious taxes to look out for in regards to liability of a target post-*Wayfair*, but they are not the only taxes to check for. Buyers should be evaluating potential exposure for all state and local taxes related to the target corporation. Several states impose successor liability for income, sales, use, and employment taxes when an acquiring entity purchases all or substantially all of a selling entity's assets. Since states are expanding their nexus provisions in light of *Wayfair*, potential successor liability is also heightened for mergers and acquisitions.

■ Keep an eye out for any issues or potential issues with trust fund taxes of a target corporation.

Comment: Responsible officers should be concerned with potential personal liability of an acquired or surviving company. Because sales and use taxes are treated as trust fund taxes in most jurisdictions, while the seller is responsible for collecting and remitting the tax, the responsible officer is liable for a failure of the company to fulfill such obligations. Because many jurisdictions do not have a statute of limitations for non-filers, a non-compliant seller may have exposure for unreported tax liabilities for as many years as the company had nexus with the particular jurisdiction—compounded by interest and penalties. In mergers and acquisitions, thorough due diligence is required to ensure that expanded nexus provisions resulting from *Wayfair* do not implicate responsible officer liability for the acquiring company.

■ Ensure target corporation's compliance with states' nexus laws both pre- and post-Wayfair, paying particular attention to those pre-Wayfair when the target may have been less aware of its obligations.

Comment: Ensuring the seller's compliance as of the effective date of the remote sales tax legislation post-*Wayfair* is not sufficient because a number of states enacted remote seller laws prior to the decision in *Wayfair*. For instance, economic nexus was not effective in Pennsylvania until July 1, 2019. However, Pennsylvania's marketplace sales legislation was already in effect as of March 1, 2018—prior to the decision in *Wayfair* and prior to the formal enactment of its economic nexus provision. Pennsylvania's marketplace sales legislation requires a remote seller with $10,000 of sales into the state annually to either collect sales tax or abide by notice and reporting requirements. Failure to do so results in hefty fines. Thus, a comprehensive due diligence must include a review of nexus laws that existed both post-*Wayfair* as well as pre-*Wayfair* and careful attention should be given to states' various nuanced rules—such as Pennsylvania's notice and reporting requirements, or expanded views of ''physical presence,'' like Massachusetts' ''cookie nexus'' (dating back to 2017).

■ *Potential income and gross receipt tax nexus and liabilities of a target company should be thoroughly evaluated.*

Comment: For over two decades states challenged the previous physical presence standard as only applying to sales and use taxes—thereby arguably permitting states to impose economic nexus upon income and gross receipts taxes**.** The U.S. Supreme Court never agreed to hear any of the economic nexus cases as applied to income and gross receipts taxes**.** With the state's win in *Wayfair* and the elimination of the ''physical presence'' standard, the path has been cleared not only for states to enact economic nexus provisions for sales and use tax purposes, but additionally any doubt as to whether the physical presence standard applied for income, gross receipts, or excise tax purposes has been eliminated. Post-*Wayfair*, states and localities are starting to apply or consider applying South Dakota's economic nexus thresholds to income, gross receipts, and excise taxes—such as the states of Washington and Hawaii, and the City of Philadelphia. Even pre-*Wayfair* many states adopted sales factor nexus, whereby a company had nexus with the state for income or gross receipts tax purposes based solely on meeting sales thresholds in the state. While many companies became aware of their sales and use tax obligations as a result of *Wayfair*, many were and are unaware of their potential income and gross receipts tax liabilities. In analyzing the impact of *Wayfair* for purposes of due diligence, buyers should take a hard look at states' income, gross receipts, and even excise tax approaches and whether a state may attempt to impose liability on the target company—and potential successor liability on the acquiring company.

■ Keep retroactivity in mind in considering any funds that should be placed in escrow.

Comment: Even those sellers who may have been compliant pre-*Wayfair* are not necessarily immune from retroactive application of the decision**.** While many states vowed not to retroactively apply *Wayfair*, those vows may have been limited to sales tax. For instance, Florida previously supported the proposition that *Wayfair* should only be applied prospectively. *Wayfair*, Brief for Colorado, et. al., at 18-19. Yet, post-*Wayfair*, in a case involving a refund of tobacco excise taxes, the Florida Attorney General argued that ''Wayfair controls the outcome of this matter, and there is no reason that case should not be applied retrospectively as well as prospectively.'' *Global Hookah Distributors, Inc. v. State of Florida*, Case No. 2017-CA-1623 (Fla. 2nd Cir. Ct.). While a state may decide not to apply *Wayfair* retroactively for sales and use tax purposes, that is not a guarantee that it will not attempt to apply the decision retroactively for other tax liabilities. Further, states may argue that they are not applying *Wayfair* retroactively—relying upon the previous income tax and gross receipts tax cases to argue that physical presence never applied to non-sales and use taxes, thereby permitting imposition of tax liability based upon many states' catchall statutory provision authorizing imposition of tax to the extent permitted by the U.S. Constitution. Therefore, the potential for retroactivity and the potential effect of retroactivity are important considerations when conducting due diligence.

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

Author Information

Jennifer Weidler Karpchuk is a Senior Counsel at the law firm Chamberlain Hrdlicka in Philadelphia. She focuses her practice on state and local tax compliance and litigation, and represents clients in a range of taxation matters, with an emphasis on the minimization of state and local tax obligations. Reach her by email at jennifer.karpchuk@chamberlainlaw.com or call (610) 772-2314.

COPYRIGHT © 2019 BY THE BUREAU OF NATIONAL AFFAIRS, INC.