UHY LLP Certified Public Accountants

# MANUFACTURING INSIDER

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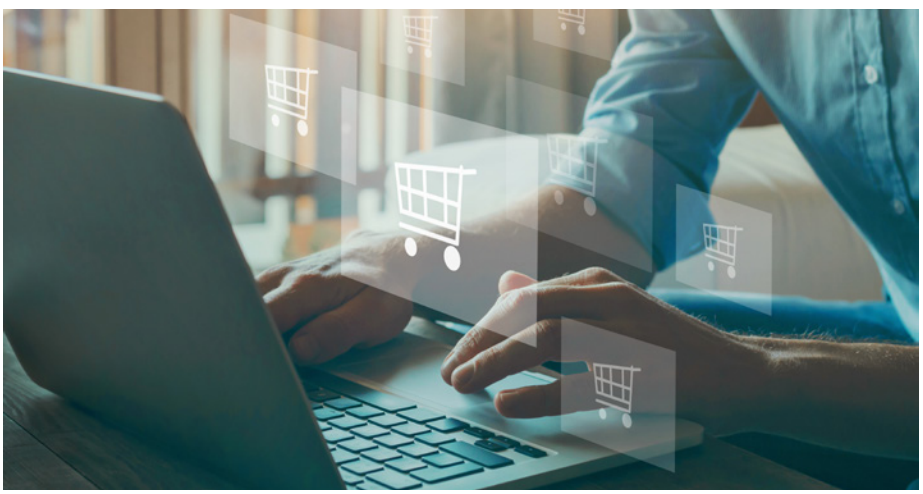

## MANUFACTURERS GRAPPLE WITH FALLOUT FROM THE WAYFAIR DECISION AND OTHER ECONOMIC NEXUS ENFORCEMENT

In 2018, the U.S. Supreme Court handed down the South Dakota v. Wayfair decision, which allowed states to require out-of-state sellers to comply with sales tax even if they lack a physical presence in the state. Over the past three years, nearly every state has enacted economic nexus laws in response to the Wayfair decision requiring sellers to register and collect tax if sales exceed a certain threshold (e.g. $100,000 or 200 transactions). Most business and practitioners agree that the Wayfair decision made light of the overwhelming compliance burden placed on businesses operating in multiple states.

Traditionally, many sales made by manufacturers are exempt from sales tax as the tax typically only imposed on retail sales, and not wholesale transactions. However certain transactions, such as sales to construction contractors and other scenarios where the customer is (or is deemed to be) the end-user, will result in tax collection obligations. Many manufacturers are also exploring direct to consumer sales channels beyond their historical wholesale customer base, which require the collection of sales tax. State economic nexus thresholds are most often based on gross sales volumes (i.e. including wholesale activity). For example, a manufacturer whose sales in a state are primarily exempt can still be required to register in the state as a sales tax vendor, file sales tax returns in the state and maintain documentation from customers to substantiate exempt sales.

Likewise, if a manufacturer purchases equipment or materials from out-of-state sellers that are subject to the law, those sellers may now be required to collect sales tax. If these purchases qualify for a manufacturing or resale exemption, the manufacturer will need to furnish the sellers with an exemption certificate to avoid the tax. As vendors learn to comply with varying state exemptions, many manufacturers will have sales tax overpayments to vendors that should be evaluated and recovered from the state.

Many states have viewed the South Dakota v. Wayfair decision to reach further than sales/use taxes. While franchise and gross receipts taxes (Ohio CAT and Washington B&O) have long had “bright-line” or “factor-presence” economic thresholds, many states have begun to also impose these nexus standards for corporate and other state income tax obligations. These nexus

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developments are especially important in light of recent challenges to P.L. 86-272.

Since 1959, P.L. 86-272 has provided businesses with protection from state income taxes when their connections within a state are limited to solicitation of sales of tangible personal property. Many manufacturers still heavily rely on this law to limit their income tax filing footprint only to those states where they have substantial operations (i.e. offices/payroll). On August 4, 2021, the Multistate Tax Commission ("MTC") adopted a revised interpretation of P.L. 86-272. Likely the most concerning items in this interpretation are the "Activities Conducted Via the Internet," which provide examples of unprotected activities. Activities interpreted to create income tax nexus when performed over the internet include: providing advice by electronic chat or e-mail on how to use products after they have been delivered (example 2); soliciting and receiving online applications for branded credit cards (example 3); remotely fixing or upgrading products by transmitting code or other electronic instructions (example 7); and selling extended warranty plans on a website (example 8). In addition to these recent interpretations of internet activity, manufacturers should be mindful whether services are performed by employees or third-party representatives that may create additional state income tax filing obligations (e.g. repairs, training, SaaS or other post-sale support).

Overall, the state tax landscape is constantly evolving and changing. While taking care of your customers and growing your business is a priority, keep in mind that evaluating state income, gross receipt and sales tax obligations is extremely challenging in light of economic nexus enforcement.

It's important to have a full picture of potential obligations and weigh compliance costs, potential liabilities and other factors when determining how to address these.

“Overall, the state tax landscape is constantly evolving and changing.”

## MANUFACTURERS STRUGGLE WITH STATE TAX NEXUS COMPLIANCE FOR REMOTE WORKERS

It's been two years since COVID-19 forced many employees to work from home. And while some employees have returned to their offices and workplaces, there are others who will continue to work from home full-time or work a hybrid schedule.

For the business, remote working has had an impact on culture, performance and staffing. And many are finding out it also has had a substantial effect on state tax nexus. As work from home becomes the new normal, these issues will only grow in significance.

During the height of the pandemic, many states provided temporary safe harbors related to teleworking and additional state tax obligations (both withholding obligations and nexus business income taxes). Most of these safe harbors have now expired and there are inconsistencies from state to state. Businesses with employees who reside in a different state are struggling to understand their tax nexus footprint.

Generally, a business is subject to a state's income tax laws when its employees work in that state. At the same time, a company that does not have any offices or other operations in a state could find itself subject to the state's income tax laws if remote workers reside in a different state.

In addition to taxes imposed on business income, employees who live in a different state than their employer impact withholding and unemployment obligations. Some states have reciprocity agreements that ensure individuals working across a state line are only subject to individual income taxes where they live, but there are other states where the guidance is muddy and confusing. Employers should pay close attention to tracking employee locations for payroll tax withholding, sales tax, and business tax purposes. Sometimes, employers lack the proper resources and systems to track employee travel and work locations on a daily basis for purposes of accurate payroll tax withholding and reporting. These deficiencies can now lead to broader tax problems, such as income and sales tax liabilities.

The shift to remote work, which appears permanent for some, should give employers plenty to ponder. State income tax, sales tax compliance, withholding and other business tax policies and procedures are complex and sometimes conflicting from state to state. Companies should lean on their tax professionals to help with this evolving situation.

## CURRENT STATE OF THE MANUFACTURING INDUSTRY

According to a new Standard & Poor's report, there are two key indicators that will tell you what kind of shape the manufacturing industry is in. The first is the Institute for Supply Management's Purchasing Manager's Index and the second is the Federal Reserve's Capacity Utilization Index for motor vehicles and parts. A reading above 50 percent for the ISM index indicates that manufacturing is expanding in the US, and below 50 means that it is contracting. History shows that each time since 1983 that the index fell below 43 percent "speculative grade" automotive companies began to panic. Similarly any time the Fed's utilization rate dropped below 72 percent during that period, it caused stress to automotive companies. Let's take a look back at the trend over the past year:

# RECENT TREND

### AS OF **JANUARY '22**

ISM Purchasing Manager's Index: 57.6%

Fed Capacity Utilization Rate: 77.3%

### AS OF **OCTOBER '21**

ISM Purchasing Manager's Index: 60.8%

Fed Capacity Utilization Rate: 76.4%

### AS OF **JUNE '21**

ISM Purchasing Manager's Index: 61.2%

Fed Capacity Utilization Rate: 75.3%

### AS OF **FEBRUARY '21**

ISM Purchasing Manager's Index: 60.8%

Fed Capacity Utilization Rate: 73.8%

## MANUFACTURING INDUSTRY INSIGHT

UHY LLP recognizes that manufacturing companies require their auditors, tax specialists and business advisors to add value to financial reporting activities. That is why we combine the strength of business and financial expertise with a hands-on, "shop floor" approach to solving complex business decisions in these key segments:

- Aerospace & Defense
- Distribution
- Automotive Suppliers
- Industrial Manufacturing
- Consumer Products

## OUR LOCATIONS

We have ample locations across the country with a heavy regional presence in the Great Lakes, Mid-Atlantic, Midwest and Northeast. Visit uhy-us.com to find an office near you.