

California adopts \$500,000 economic nexus threshold for use taxes

Be warned: Some California businesses are now subject to increased district tax collection requirements.

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It's official. The Governor has signed AB 147, which increases California use tax economic nexus threshold to \$500,000 of sales of tangible personal property in California, effective April 1, 2019.

The CDTFA previously announced that it would begin enforcing the **Wayfair** economic nexus threshold of \$100,000 of sales or 200 transactions, effective April 1, 2019, but AB 147 supersedes the CDTFA's threshold. For information on the CDTFA's announcement, see "California adopts \$100,000/200 transaction **Wayfair** threshold" in the January 2019 issue of *Spidell's California Taxletter*.®

AB 147 brings welcome relief to some small California businesses because:

- The \$500,000 threshold means that a greater number of small businesses are not required to comply with increased district tax collection and reporting requirements (unless, of course, they have physical nexus in the district);
- It does not contain a transactional threshold, so sellers without physical nexus in a district can make an unlimited number of sales without having to collect district taxes as long as its total California sales are below \$500,001; and
- It shifts much of the collection requirements to marketplace facilitators such as Amazon.

While that's the good news, AB 147 might very well subject far more California businesses to increased district tax collection requirements.

District tax collection requirements

AB 147 requires retailers that make over \$500,000 of sales in the state to begin collecting and remitting all district use taxes for sales made to customers in any district in the state, even if the retailer does not meet the threshold in the district in which the customer is located.¹

Prior law

The district tax collection requirement is a dramatic change from both:

- Pre-**Wayfair** law, when California retailers were not required to collect district taxes if they made a sale to a customer located in a district in which they didn't have a physical presence (they were only required to collect the statewide rate, and the customer was supposed to remit the district use tax); and
- The CDTFA's policy that went into effect on April 1, in which the CDTFA took the position that retailers would only be required to collect district taxes when they made over \$100,000 in sales or 200 transactions *in that district*.

Example of winner and loser: Small Business, Inc. has \$375,000 in tangible personal property sold to customers in California. \$125,000 of that amount is sold to customers in District A, \$110,000 sold in District B, and \$105,000 sold in District C. The remainder of the sales are sprinkled throughout other districts. Under the CDTFA's previous ruling, Small would have to collect sales tax from Districts, A, B, and C as well as from sales sold in the district of their location.

Under AB 147, Small will collect district tax only in its own district and not Districts A, B, or C.

Smaller Business, Inc. has \$550,000 in total sales in California. However, they had no more than \$75,000 in sales to districts outside their own. Under the CDTFA's previous policy, they would not be required to collect district taxes in any district except their physical location.

Under AB 147, Smaller must collect district tax because their total sales of tangible personal property was greater than \$500,000.

How to track district tax rates

There are hundreds of taxing districts in California.² To help retailers determine which district a customer is located in, the CDTFA has created a look-up tool, Find a Sales and Use Tax Rate by Address. While this is a helpful resource, it means that retailers must enter each customer's address to determine the correct district.

The CDTFA has also developed a tool that may or may not be successfully integrated into your sales software that can automate this function. To see if this service will work with a software application, select the Looking for the Tax Rate API? link at the bottom of the Find a Sales and Use Tax Rate by Address page.

The direct link may be found here:

<http://services.gis.boe.ca.gov/api/taxrates/>

How does the threshold work?

Effective April 1, 2019, the economic nexus threshold is \$500,000 of sales in the preceding calendar year or the current calendar year. The \$500,000 threshold includes all sales made by persons related to the retailer, as defined by IRC §267(b).³

Although a retailer is not required to begin collecting use taxes until April 1, 2019, it must look at its sales receipts for 2018 and the receipts to date for 2019 to see if the threshold is met in either 2018 or 2019. It also means that even if they don't meet the threshold in 2020, they will still be required to continue to collect state and district taxes if their sales in 2019 exceed \$500,000.

Example of fluctuating sales: In 2018, Spanky Tankys, an online retail business based in Santa Ana that sells customized aquariums, has over \$500,000 in California sales and must begin collecting all district taxes on its sales beginning April 1, 2019. In 2019, Spanky's California sales drop to \$400,000. Spanky must continue to collect all district taxes in 2019 even though their sales are below the \$500,000 threshold because they exceeded the threshold in 2018. However, in January 2020, Spanky no longer has to collect California district use taxes, other than the district tax in Santa Ana where they are based.

In early 2020, Spanky has several big California sales, and by April 30, 2020, its total California sales for 2020 exceed \$500,000. Spanky must begin collecting and remitting California district taxes on all its sales beginning May 1, 2020.

Sales made by marketplace facilitators

One saving grace for businesses like Spanky in the example above is if most of its sales are made by marketplace facilitators that have over \$500,000 in California sales (think Amazon), the marketplace facilitator is responsible for collecting the state and district taxes.⁴

Physical presence nexus hasn't gone away

Even if a California or out-of-state retailer's sales are below the economic nexus threshold, they must still register and collect California taxes if they have physical presence in the state or a district. If their inventory is stored in a California warehouse, they have physical presence in that location.⁵

This is a huge trap for retailers whose inventory is stored in Amazon distribution centers in California and recently the CDTFA has been quite aggressive in going after these retailers. However, if these retailers' sales are below the \$500,000 threshold, they will only be required to collect California district taxes in those districts in which the distribution center is located.

Out-of-state sales made by California businesses

Whether a California business must collect other states' state and local use taxes on sales made to customers in those states is determined by those states' rules, not California's rules. Most states have adopted the **Wayfair** economic nexus threshold of \$100,000 in sales or 200 transactions. We've put together a 50-state table outlining other states' economic nexus thresholds that we update on a regular basis. The table can be accessed at:

www.caltax.com/spidellweb/public/editorial/CAT/0818CAT-nexuschart.pdf

Out-of-state retailers selling to California customers

Out-of-state retailers selling to California customers must register with the CDTFA and collect California state and district use taxes effective April 1, 2019, if their sales meet or exceed the \$500,000 threshold.⁶

Upcoming webinar

If you need more information on AB 147 and the **Wayfair** case and its effect on businesses, attend our upcoming webinar, "**Wayfair**: California rules," on May 30. Visit www.caltax.com under the Webinars tab for more details.



¹ R&TC §7262

² See www.cdtfa.ca.gov/taxes-and-fees/sales-use-tax-rates.htm

³ R&TC §6203(c)(4)

⁴ R&TC §6402

⁵ R&TC §6203(c)(1)

⁶ R&TC §6203(c)(4)