Wayfair Creates New Challenges for the Construction Sector

For construction companies, finding answers in a sea of questions about their tax obligations in a post-Wayfair environment can feel a bit like the hunt for Nemo. With layers of moving parts in nearly every project, the very nature of the construction process has always made tax compliance a complex and challenging responsibility. Changes following Wayfair add further complication to this basic business chore.

The Supreme Court's decision in South Dakota v. Wayfair upended decades of tax policy that had exempted most sales by out-of-state businesses from state sales tax except where sellers met the standard to establish physical presence. The ruling freed states to set their own rules regarding sales tax nexus by eliminating the physical presence requirement.

As a result, states quickly began crafting a wide variety of legislative changes to start collecting additional revenue. Construction companies must in many cases now collect, remit, and report state sales and use tax on products and services they provide to buyers in states where the business has no physical presence. In some states, economic nexus for income tax purposes hinges on sales tax, so revised nexus rules also hold the potential to dramatically alter a company's overall tax picture in one or more states.

Determining nexus starts with a close look at the company's revenue-generating activities state by state, both in terms of total sales and by the number of transactions. That is easier said than done for construction contractors, however, since state rules around taxability of construction products and services exhibit such vast variability. A given product or service that is taxable in one state may or may not be taxed in neighboring states.

Each state applies its own guidelines for taxable and nontaxable items and activities as well as differing tax rates for taxable elements – guidelines that rarely mirror the rules in other locations – and the factors that govern taxability and applicable tax rate are almost infinite. States may distinguish between some, none, or all of the following factors in setting tax rates for the products and activities deemed as taxable in the state:

- Type of project
    - New construction versus repairs or remodeling
    - Residential, commercial or another category
- Type of customer, i.e. individuals and businesses versus tax-exempt organizations and government entities
- Type of payment structure for the contract, i.e. lump sum as opposed to cost plus or other payment arrangements
- Company role in the project, i.e. general contractor versus subcontractor
- Products versus services
- Other characteristics of individual projects, project components, businesses and arrangements

As this partial list makes clear, even answering the basic question of whether nexus is present may require extreme effort and detailed analysis of projects and sales. Construction companies must allocate adequate resources to monitor and evaluate their sales tax obligations in every state where they create revenue. Most should expect to add one or more employees focused on helping the business fulfill this responsibility or to seek outsourced assistance from external specialists.

While many states have already passed legislation in response to Wayfair, some have not yet done so but will in the future. It is also important to note that states continuously update and revise their sales tax policies, including which items or activities are considered taxable. Unfortunately for construction contractors, that means the job of monitoring and meeting evolving sales tax requirements is not one that can ever be considered complete. With each new contract and passing year, the situation may be different in every state where the company has projects or sales.

Establishing economic nexus for sales tax in the state can also trigger the requirement to collect sales and use tax for municipalities and other local jurisdictions. Construction companies must watch for these potential triggers and add them to their list of tax obligations, where present.

They should also devote adequate attention to managing and monitoring sales tax exemption certificates from their customers. Expiration dates and other exemption regulations vary by state, so tracking the validity of certificates is of paramount importance if contractors are to remain in compliance.

Similarly, construction companies must closely monitor invoices from suppliers and subcontractors to ensure the company does not pay unnecessary sales tax. Since vendors and subs are also adding sales tax to more of their invoices, company leaders should verify that any applicable exemptions are applied before issuing payment.

Wayfair has undeniably made tax compliance more difficult for construction businesses. Even if the tax the company itself owes does not increase dramatically, determining its obligations regarding sales and use tax has become infinitely more burdensome. To minimize the impact of these increased challenges, you can count on the tax professionals at Mauldin & Jenkins. We understand how to help your construction business remain competitive and compliant in a post-Wayfair world.

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