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Collecting and Remitting PA Sales Tax on Multistate Sales Transactions

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A number of factors must be considered by sellers and purchasers when evaluating sales and use tax compliance for transactions involving multiple states. Among other things, a seller must consider the location of delivery to the purchaser (which may depend on the method of delivery), whether the seller has nexus with the destination state, and, if so, whether the property is taxable in the destination state. Sellers must also verify exemption certificates provided by purchasers who claim a tax exemption, which may require an analysis of another state's rules with which the seller is less familiar.

A purchaser must consider whether tax was properly collected by the seller, whether it is required to remit use tax on property when the seller did not collect tax, and the tax implications that arise when property is delivered in one state but will ultimately be used by the purchaser in one or more other states.

Common issues that arise in multistate transactions are discussed below, with an emphasis on Pennsylvania law.

Location of Delivery

For sales and use tax purposes, a sale occurs in the state where the property is delivered to the purchaser, which may be a location different than the purchaser's business address. This is a basic principle of sales and use taxation, but it is not uncommon for an auditor to discover that a seller has failed to collect Pennsylvania tax on a sale of property to an out-of-state customer where the customer picked up the property in its own truck at the seller's place of business. The fact that a nonresident purchaser will immediately transport the property to a location outside Pennsylvania for use outside the state does not change the taxable nature of the transaction. See 61 Pa. Code § 32.5(a), (b). Furthermore, delivery in the state to a purchaser's agent, other than an interstate carrier, constitutes delivery to the purchaser. See 61 Pa. Code § 32.5(b).

Pennsylvania sales tax does not apply to property that is actually delivered to a location outside Pennsylvania, or to a common carrier or the United States Postal Service for transportation to a point outside the state. A seller who has nexus with the destination state is, however, required to collect tax imposed by the destination state on non-exempt sales of property delivered to customers in that state. The degree of physical presence required to create a tax collection obligation in another state is not high. For example, a seller who directly or indirectly engages in regular solicitation activities in another state likely has an enforceable obligation to collect tax on behalf of that state, even when it conducts those activities through an independent contractor. A seller may also create a tax collection obligation in another state by delivering products to customers in that state in its own vehicles.

It is important to both sellers and purchasers that the delivery location be properly identified on the invoice or other supporting documentation, especially when the purchaser has multiple business locations and the billing address and delivery location may be in different states. If an invoice reflects a billing address in a particular state, an auditor will assume that the billing address reflects the delivery location in the absence of evidence to the contrary (such as designation of a different address as the "Ship To" location or attachment of shipping documents).

Drop Shipment Transactions

A "drop shipment" transaction occurs when a retailer accepts an order for products from a customer and then places the order with a supplier (manufacturer or wholesaler) and directs the supplier to deliver the goods directly to the retailer's customer. These transactions involve at least two sales transactions – the sale from the supplier to the retailer and the sale from the retailer to the consumer. These types of arrangements create numerous sales and use tax issues. Tax compliance is further complicated by the fact that there is little consistency among the states regarding the tax treatment of drop shipment transactions.

One of the most common issues that arises in drop shipment transactions is whether the supplier can accept a resale certificate from the retailer under the laws of a particular state. For example, some states do not permit a seller to accept a resale exemption certificate "in good faith" from a purchaser that is not registered to collect sales tax in the state. If the supplier cannot accept a resale certificate from the retailer, the supplier may be obligated to collect tax on the transaction.

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Another potential issue arises when the supplier delivers property to a customer in another state in which the supplier has nexus. A number of states have statutes purporting to make a "former owner" of property liable to collect tax as the "retailer" when it delivers property to a consumer in the state. In some cases, the statutory tax collection obligation extends to deliveries to another person (e.g., a carrier) for redelivery to a consumer in the delivery state. See, e.g., Cal. Rev. & Tax. Cd. § 6007. When a supplier is required to collect tax on a drop shipment transaction because it has nexus with the delivery state, issues also arise as to the proper tax base (the amount the supplier receives from the retailer versus the amount paid by the consumer).

When delivering property to a consumer in Pennsylvania, a seller may accept a resale certificate from an out-of-state retailer that does not have a Pennsylvania sales tax license number. See Ruling No. SUT-99-134 (reissued February 16, 2010). The resale certificate must indicate that the retailer does not have nexus with Pennsylvania or that no taxable sales are made in the state.

Services To Tangible Personal Property

In Pennsylvania, sales tax generally applies to services to tangible personal property (repairing, altering, cleaning, etc.), absent a specific exemption. See 72 P.S. § 7201(k). Notwithstanding the fact that taxable services to tangible personal property may be performed within Pennsylvania, those services may be nontaxable if the serviceperson is obligated to deliver the property to a point outside Pennsylvania (or to an interstate carrier or the mails for transportation to a point outside the state). See 61 Pa. Code § 32.5(b).

Similarly, when a taxpayer obtains taxable services to Pennsylvania-based tangible personal property at a location outside Pennsylvania, and then brings the property back into the state, Pennsylvania use tax is due on those services (subject to any available credit for tax properly paid to the other state).

Credit for Tax Paid to Another State

When property is initially delivered to the purchaser in another state but subsequently brought into Pennsylvania, Pennsylvania will grant credit for state sales and use taxes legally paid to the other state, provided that the other state grants similar tax credit for taxes paid to Pennsylvania. Pennsylvania will also grant credit for local sales and use taxes, provided such taxes are: (1) collected by the state, and (2) paid pursuant to the provisions of the state law which has been adopted by the local government. Claims for tax credit must be substantiated by evidence showing tax has been paid. Credit for taxes paid to another state will be applied first to state tax, then to local tax.

It is important to remember that Pennsylvania will grant a credit for sales or use tax previously paid to another state only if the Department of Revenue determines that the tax paid to the other state was legally required to be paid. For instance, with respect to property that is temporarily stored in another state prior to entering Pennsylvania, the Department of Revenue's Audit Manual indicates that a tax credit for sales or use tax paid to the other state will be recognized if that state taxes interim storage and has reciprocity with Pennsylvania. However, credit will not be allowed for tax paid to another state if that state does not tax interim storage because the tax paid to the other state was not "legally due."

Special Resale

In Pennsylvania, a special provision in the statutory definition of "resale" applies to "tangible personal property purchased or having a situs within this Commonwealth solely for the purpose of being processed, fabricated or manufactured into, attached to or incorporated into tangible personal property and thereafter transported outside this Commonwealth for use exclusively outside this Commonwealth." 72 P.S. § 7201(i)(3). This "special resale" exclusion allows taxpayers to manufacture or fabricate tangible personal property tax-free in Pennsylvania, then use or install it in a state where it would be subject to a lower tax rate, or would be entirely exempt.

Pennsylvania does not have an interim storage exemption. Therefore, without the "special resale" exclusion, Pennsylvania producers would have to pay Pennsylvania tax on materials and could be placed at a competitive disadvantage to out-of-state producers in low-tax or no-tax states. A classic example of a business that benefits from the "special resale" exclusion is a business that fabricates custom cabinetry or other building components to be installed in buildings outside Pennsylvania. But for the "special resale" exclusion, a company fabricating building components in Pennsylvania and installing them outside the state would owe Pennsylvania sales or use tax on the cost of the materials, even when the components are destined for installation in a state with a lower tax rate or no sales tax at all.

Under some circumstances, companies with offices in multiple states can also use the "special resale" exclusion to claim an exemption for property that is temporarily present within Pennsylvania so that the purchaser can perform some type of operation on the property prior to delivering the property to an out-of-state location for use outside the state. For example, if a company purchases computers in Pennsylvania, attaches additional hardware components, and then ships the computers to offices outside the state, the computers and components should qualify for the "special resale" exclusion. Similarly, since canned software is treated as "tangible personal property" for sales tax purposes, installing such software on a computer prior to delivering the computer to an out-of-state location should satisfy the statutory requirements for "special resale." The exclusion does not, however, apply in situations where a company has property delivered to

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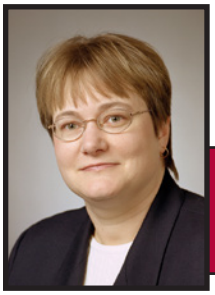
Pennsylvania due to centralized purchasing operations, and then simply re-ships the property to business locations in other states. In order to qualify for the "special resale" exclusion, some operation must be performed on the property or it must be "attached to" or "incorporated into" other tangible personal property before being shipped outside the state.

An issue that sometimes arises when a business claims the "special resale" exclusion for moveable items is whether the taxpayer can demonstrate that the property transported to an out-of-state location will be used "exclusively" outside Pennsylvania. For example, the Department has taken the position that the "special resale" exclusion does not apply to laptops purchased for employees in other states on the basis that the laptops could easily be used in Pennsylvania. It is possible that almost any type of property could conceivably be brought back into Pennsylvania, depending on future circumstances. Therefore, in determining whether property will be used "exclusively" outside Pennsylvania, a more appropriate inquiry would be whether an item is intended to be used both in Pennsylvania and in other state(s) when it is purchased and shipped outside the state. If not, it should be considered to have been purchased and transported outside Pennsylvania for "use exclusively outside [Pennsylvania]." If the property is subsequently brought back into Pennsylvania for some reason, use tax could be due at that point. ■

For advice on multistate sales and use tax compliance issues, please contact Sharon Paxton or another member of the McNees State and Local Tax Group.



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