



Podcast Transcript

Taxing Santa: A Satirical Summary of 2020 State Tax Issues

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Hunsaker: Hey folks, welcome to the State Tax Show. This is Matt Hunsaker. Today we have a light little discussion of how changes to the state tax landscape affect Santa Claus.

Everybody's pretty busy this time of year, so the podcast listenership usually takes a bit of a dip towards the end of the year. So, I'm going to do something fun, maybe a little silly, but hopefully it does offer just a bit of insight into how complex the world of state tax has become. What we're going to do is take a closer look at the tax implications to Santa Claus.

There has been some speculation that, like the Dormant Commerce Clause, Santa Claus doesn't exist. Now, I'm not going to get into that speculation, so for today, we will assume that both Clauses are alive and well. If I were a scholar, I'd put these in some meaningful order, but we're going to go stream-of-consciousness today.

The first question is whether Santa Claus qualifies for the manufacturing exemption for equipment and raw materials that go into his toys at his North Pole facility. Now, there's no question he is manufacturing up there. You could just ask the elves. Luckily for Santa, though, his facility appears to be outside of the taxing jurisdiction of North Pole, Alaska, which, I might add, is one of the few localities that have sales tax in Alaska. And if he is truly at the geographic North Pole, then he's home free because no country owns the North Pole.

But let's assume that he has shops set up around the U.S. Well, the fact that he gives away his product for no consideration could be a problem. Most

manufacturing exemptions apply only to manufacturing products for sale in the ordinary course of business, and I don't know if promises of little boys and girls to be good qualifies as consideration. So, Santa should be concerned about qualifying for the manufacturing exemption.

While we're talking about consideration, what about the exchange to the children? Assuming there is no consideration, there is no taxable sale, and the children don't owe sales or use tax. I'm sure children everywhere will sleep much better knowing that. And we're lucky that there's no sales tax, because if they were taxable, then we'd have to deal with the thorny question of whether delivery by Rudolph and company was included in the sales price or whether there was a separately stated non-taxable price for the delivery, which I think you could argue is being provided when you set out milk and cookies, which traditionally have been the consideration for the delivery service.

The kids may be safe from sales tax, but again, I think St. Nick may have some potential use tax issues. Giving away toys may be deemed a taxable use in many states, as it does not involve retaining the goods for sale or display in the ordinary course of business. Santa may argue that he does not have nexus, but good luck with that. There's always been some uncertainty about how much physical presence you can get away with as de minimis, but I suspect that going down each and every chimney in a particular state, even though it takes probably just a few minutes and once a year, is probably more than de minimis presence. But if Santa were to hire me, I would argue that Wayfair did away with the physical presence requirement both for the state and for the taxpayers. States can't have it both ways, but that's a discussion for another day.

Now, you're gonna want to plug your children's ears for this one. What if Santa has laid off the elves, it has been a tough 2020 after all, and instead delivers products manufactured by toy companies? Let's put aside the sale and economic considerations for a moment. The question I have is whether Santa could be treated as a marketplace facilitator. Think about it for a second. The little kids want toys, toy manufacturers want to sell toys, and who is it that brings them all together? Santa. He and Mrs. Claus take orders at the North Pole, and forward those orders to the toy manufacturers, who accept the orders. Back when I was a kid you had to write a letter to Santa, but now this can all be done online. You may be wondering whether Santa has surpassed the economic thresholds for a marketplace facilitator to have a collection responsibility. Well, I think we can pretty easily determine that Santa Claus processes well in excess of the \$100,000 to \$500,000 thresholds in the states, and certainly the 200 transaction tests in some other states. But not all is lost for our jolly old friend. Some states have started exempting restaurant and other delivery companies from marketplace facilitator laws, so surely any state with sound tax policy would exempt Santa Claus, Rudolph and company from being a marketplace facilitator when they're just delivering packages on behalf of vendors.

I read just about every state tax case that comes out, but I have not yet seen a state take the position that a toy company has nexus in the state as a result of deliveries by Santa. Now, maybe it's tucked away in a brief somewhere, but I just

haven't found it yet. On the sales tax front, I think there's an argument that Santa Claus is essentially a common carrier, and delivery into a state via common carrier does not create nexus. That is, of course, assuming the toy company doesn't breach the economic nexus thresholds resulting from the Wayfair decision and the legislation passed by the states as a result. But what about income tax nexus? Let's assume that a state has factor presence nexus. You know, that's where if you have a certain level of sales, property or payroll in the state, then you have nexus regardless of physical presence. Let's also assume, for our little hypothetical here, that a toy company only makes sales into that state delivered by Santa Claus and has no other activity in the state. If that company's sales exceed the income tax factor presence threshold, is it subject to income tax? The state statute would say yes. But don't forget about Public Law 86-272. I think, in this case, the only activity in the state is solicitation of orders that are taken by Santa, sent out of state for approval, and then delivered from out of state by Santa. To me, it seems like a clear-cut case of federal preemption, so those toy companies should not be subject to income tax.

There's probably a lot of other state tax implications, but I think that's good enough for now. So, in summary, it looks like Santa and the toy companies may be doing alright, but there's definitely some tax exposure out there. So my final question to you is, what happens if a person were to bring a False Claims Act suit against Santa? Well, I think any child could tell you the consequence. Nothing but coal in their stockings from here on out.

I'm going to try to squeeze in a final episode of this season next Monday, so check back. But if I don't get around to it, have yourselves a great New Year, and we'll be back for season four.

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