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Electronic Commerce

INSIGHT: The Supreme Court Will Determine Who Has to Do the Sales Tax Collection Dirty Work



BY DARCY KOOIKER AND MARY BERNARD

Recall how Mark Twain's wily Tom Sawyer conned his friends into doing Tom's chore of whitewashing the fence? Similarly, states have spent a lot of time and effort to get remote merchants that sell goods online to do the unpleasant task of collecting sales tax from customers because it is administratively difficult and unpopular for a state to collect the tax itself. The U.S. Supreme Court is now poised to determine who is required to do this dirty work, and the state and local tax community is holding its collective breath awaiting the decision and anticipating the fallout from what has been called the "tax case of the millennium" by the National Conference of State Legislatures.

South Dakota v. Wayfair Inc. is challenging the long-standing concept upheld in *Quill Corp. v. North Dakota* in 1992, which said that a state could not impose a sales tax collection and remittance requirement on a seller with no physical presence in the state. This concept was blatantly challenged in 2016 when South Dakota legislators passed S.B. 106, requiring remote merchants with no physical presence in the state to collect and remit South Dakota's sales tax, upon meeting certain threshold requirements. Under this law, tax collection is imposed if either of the following criteria is met:

1. The remote seller's annual gross revenue of sales of tangible property, any products transferred electronically, or services delivered into South Dakota exceed

\$100,000; or

2. The remote seller has 200 or more separate transactions of tangible property, any products transferred electronically, or services delivered into South Dakota per year.

As soon as the law was passed, the state sued three retailers, including Wayfair, for not complying with the new law. These retailers were presumably specifically targeted because they sell large-size and high-value items in competition with local brick and mortar sellers. The cases were consolidated and became known as the *Wayfair* case. Once Wayfair successfully argued in a lower court that the tax imposition violated *Quill*, the case rose quickly to the Supreme Court. Prior to oral arguments, many people thought that *Quill*'s physical presence requirement would be overturned. However, the nature of the justices' comments surprisingly indicated they recognize that the states could collect the tax from customers themselves and questioned how significant a burden it is on the merchant to collect and remit the tax. Speculation now abounds as to the possible outcomes of this case. Here are the potential scenarios:

Wayfair Wins

If Wayfair wins and physical presence remains the test for tax collection, the states will look to alternative methods to disrupt the status quo. This could mean that they continue to push the limits of physical presence with aggressive attributional nexus rules, like New York's rebuttable presumption of click-through nexus or by finding physical nexus in the most unlikely places, such as Massachusetts' determination that physical nexus exists via rented servers, data, or even digital cookies downloaded in the state. Some states might decide to follow Colorado's controversial model of giving merchants a "choice" of either voluntarily collecting the tax or following a customer-notification procedure and reporting customers' sales information to the state. Either way, the result would likely be increased tax compliance requirements and more uncertainty for merchants previously protected by *Quill* in states where they had no physical presence.

South Dakota Wins

If South Dakota wins and *Quill's* physical presence requirement is removed, e-commerce merchants can expect a significant increase in their sales and use tax reporting and data accumulation responsibilities, despite the state's arguments that sales tax collection is now cheap and easy for merchants due to technological advances. Fortified with a win, many states would most likely impose similar dollar and transaction thresholds for nexus, with very little uniformity among the states. Furthermore, the recordkeeping necessary to comply with potentially 10,000-plus taxing authorities would be excessive, at best. Merchants will first need to do research and determine if their goods and services are subject to tax in each jurisdiction, then determine if each customer's transaction is exempt from the tax due to a resale or other exemption circumstance. Merchants will likely start charging sales tax and have an extreme bookkeeping challenge when customers subsequently provide exemption certificates.

If the Court awards a win to the state and does not impose any restrictions or guidelines, unresolved issues would include:

- Will this be applied retroactively?
- Is one transaction in the state enough to create nexus?
- What about foreign entities selling into the states, formerly protected by the physical presence requirement?

These issues alone could have far-reaching impacts.

Case Is Remanded to Develop Facts

The justices appeared exasperated about the wildly conflicting facts presented by both sides about the burden of collecting sales tax imposed on e-commerce merchants. Therefore, it is also possible that the Court will remand the case to develop the facts. In this scenario, states will use their best charm to argue that compliance for the collection and remittance of additional sales taxes is not a burden for merchants, stating that software easily can handle the increased transaction capacity and recordkeeping. At the same time the case is being reconsidered, states may creatively and aggressively assert new economic nexus tests by law, rule, or policy and/or push the limits of physical presence requirements. These actions will severely overburden

small e-commerce businesses with administrative tax compliance duties and financial liability if they fail to collect and remit the taxes correctly.

Congress May Finally Act

In any of these scenarios, Congress may step in to impose its own idea of who needs to collect the tax. For many years, Congress has introduced but failed to act upon so-called marketplace fairness legislation that would require remote merchants to collect sales taxes. Two versions of this legislation were introduced in 2017 but saw no movement.

However, not everyone agrees this is the solution. Conjuring images of tea being dumped in the harbor, Rep. Jim Sensenbrenner (R-Wis.) sponsored the No Regulation Without Representation bill which would codify *Quill* and make physical presence necessary for a state to impose tax collection responsibilities on the merchant.

Next Steps for Merchants

Whatever the outcome of this landmark case, merchants that sell to customers in other states will need to carefully watch the states' actions for imposing new nexus requirements or reporting obligations. They will then need to research if their products and services are subject to the destination state's taxes and if the customer is exempt or will be providing an exemption certificate. If the tax needs to be paid, the merchant will need to register with the state to become a taxpayer, then determine the correct rate of tax to charge. Tax consultants can help with all of these issues, and some can assist to find the right software and outsourced compliance solutions to help with this entire process.

While the states claim tax collection and reporting is easy, we all know the devil is in the details, and merchants can be audited and held liable for tax, penalties, and interest if they do it wrong. While the customer is ultimately liable for paying the tax to the state, the states think the chore of collecting the tax should be the privilege of somebody else.

Author Information

Darcy Kooiker is a principal and Mary Bernard a director at Ryan LLC.