Sellers

There is No Nexus Standard Today: In overturning Quill, by removing the physical presence requirement for sales tax nexus and upholding the South Dakota nexus standard, the Court provides specific criteria under which a state's sales tax laws ...

Michael T. Dillon • Jul. 31, 2018

In part two, I discussed the physical presence sales tax nexus standard and the South Dakota nexus standard as they relate to Wayfair. Now, I will discuss what all this means for remote sellers, the particular states they sell in and what the future might hold.

[Read Part 1 — Read Part 2]

WHAT DOES THIS MEAN FOR REMOTE SELLERS?

There is No Nexus Standard Today: In overturning *Quill*, by removing the physical presence requirement for sales tax nexus and upholding the South Dakota nexus standard, the Court provides specific criteria under which a state's sales tax laws

applicable to remote sellers will properly establish substantial nexus, given repeal of

which eliminates concerns relating to the retroactive application of the Court's decision and historical liabilities for every taxpayer that has relied on the physical presence standard as a means for determining their sales tax compliance requirements in South Dakota. States that adopt the South Dakota law could do so prospectively, resulting in an influx of newly registered taxpayers, effectively under amnesty, as most states would likely not focus enforcement efforts on the past since their efforts are focused on enforcing the new legislation.

However, the Court did not specifically limit the constitutionality of sales tax nexus standards to the South Dakota law. As Justice Kennedy said, the Court's Commerce Clause jurisprudence avoids formal standards in favor of "a sensitive, case-by-case analysis of purposes and effects." As such, while the Court's analysis of the South Dakota nexus standard establishes a threshold over which the Court should likely uphold the constitutionality of a state nexus standard, the Court in *Wayfair* did not establish clear guidelines as to what other state nexus standards are constitutional. This approach would only explicitly benefit the other states that adopted the same South Dakota nexus thresholds, and could otherwise merely serve to support and proliferate the nexus standards that the remaining states adopt to expand their taxing authority, causing even more damage and uncertainty in state taxation.

Retroactive Application: While the Court noted that South Dakota's law applies prospectively – something it considered a protection against undue burdens on interstate commerce – the Court did not require the prospective-only application of its decision. As such, the Court left open the opportunity for the most aggressive states to pursue retroactive application of the reversal of *Quill,* enabling states to assert nexus over remote sellers as far back as states choose to pursue sales taxes for historical periods.

Where do I Have Nexus? Barring any determination on remand to the lower court

presence nexus for a remote seller before the state may assert sales tax compliance requirements. As such, these states theoretically would arguably have to address this legislatively or administratively prior to requiring remote sellers to collect sales tax on sales to customers in their jurisdiction. This leaves 31 states that adopted some method for imposing sales tax compliance obligations on remote sellers, either considering certain activities to constitute physical presence or by ignoring the physical presence requirement. Of these states, and as summarized in the Tax Foundation map, we observe the following:

South Dakota-style Economic Nexus Provision: At least 12 states – South Dakota, Hawaii, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, North Dakota, Rhode Island, Vermont and Wyoming – adopted economic nexus laws with similar threshold limitations that balance the needs for state collection against the need for uniformity, rate simplification, a *de minimis* threshold of $100,000 in annual sales or 200 individual transactions, and seeking prospective application. South Dakota's law also seeks to meet the Court's four-pronged test set forth in *Complete Auto Transit v. Brady*, ensuring that it does not discriminate against interstate sales and only taxes the state's fair portion of activity in the state. [430 US 274 (1977)]

Notably, South Dakota is a member of the Streamlined Sales Tax Project, meaning they have already simplified their sales tax laws to promote simple and uniform application on interstate commerce. The most recent federal bills promoting taxation of interstate commerce (*See* Marketplace Fairness Act and Remote Transaction Parity Act) both require similar simplification efforts by a state prior to the state requiring remote sellers to collect sales tax. Each of the other states has adopted the South Dakota nexus thresholds in their law.

Alabama-style Economic Nexus Provision: At least seven states, including Alabama, Connecticut, Georgia, Iowa, Massachusetts, Mississippi, Ohio and Tennessee,

adopted economic nexus laws that assert nexus, regardless of whether the remote

remote seller exceeds a certain sales threshold in the state. Even though the "economic nexus" threshold of these provisions may survive constitutional scrutiny under the Court's *Wayfair* decision, they may be subject to challenge on the grounds that they violate one of the other prongs of the Court's Commerce Clause doctrine set forth in *Complete Auto Transit*.

Marketplace Standard With Economic Nexus Provision: At least eight states – Alabama (eff. 1/1/19), Connecticut (eff. 12/1/19), Iowa (eff. 1/1/19), Minnesota (eff. 7/1/19 or if *Quill* is overruled), Oklahoma, Pennsylvania, Rhode Island (eff. 8/1/18) and Washington State – adopted marketplace nexus standards with economic nexus provisions. In the provisions, remote sellers, as well as marketplace facilitators (Amazon, for example), are subject to notice and reporting requirements, or may elect to collect and remit sales tax if they have more than typically $10,000 in annual sales, despite a lack of physical presence in the state.

Pursuant to these laws, Amazon agreed to collect and remit sales tax on behalf of all remote sellers for sales made on its platform in Oklahoma, Pennsylvania, Rhode Island and Washington. However, this does not protect such remote sellers from the enforcement of these provisions against them to the extent they sell on other platforms, including their own websites. Remote sellers must still collect and remit on these sales, particularly now that Amazon has already elected on their behalf to collect and remit, relative to the remote sellers' sales transacted through the Amazon platform. Conceivably, these states would not have to change a thing to enforce sales tax compliance (including any notice and reporting requirements) over remote sellers, so long as the remote seller exceeds a certain sales threshold in the state. Even though the "economic nexus" threshold of these provisions may survive constitutional scrutiny under the Court's *Wayfair* decision, they may be subject to challenge on the grounds that they violate one of the other prongs of the Court's Commerce Clause doctrine set forth in *Complete Auto Transit*.

Existing Nexus Standards in States That Have Not Adopted Economic Nexus: Each

collect and remit sales and use tax." Arguably, the Texas Comptroller may assert nexus over remote sellers under this regulation without waiting until the next legislative session, or even going through the administrative process to amend its regulations.

Click-through or Affiliate Nexus Provisions: At least 37 states adopted click-through or affiliate nexus provisions. Such laws may be insufficient to assert economic nexus over a remote seller, as these standards are premised on having a "click-through" agent or affiliated entity physically present in the selling state. Furthermore, while tens of thousands of remote sellers use click-through and affiliate relationships (Amazon, again, for example) to market their products, many remote sellers do not use such platforms. As such, these provisions, alone, do not enhance state efforts to assert sales tax nexus over remote sellers.

Notice & Reporting Requirements: At least 13 states adopted the Colorado-style notice and reporting requirements. The Court is not addressing the constitutionality of these laws, so it remains unclear how, or if, states would continue to exploit these requirements to "encourage" remote seller compliance. As such, these provisions, alone, do not enhance state efforts to assert sales tax nexus over remote sellers.

NOTE: This certainly does not mean that certain states, particularly the most aggressive states such as California, would cease their enforcement efforts over remote sellers. Many remote sellers maintain inventory in the warehouses of Amazon and other third parties that facilitate the sale of a remote seller's product through a marketplace. Even under the existing *Quill* physical presence standard, most sales and state and local tax (SALT) professionals will agree that this establishes physical presence for sales tax purposes. Though the argument exists that such remote sellers are not "retailers" within state sales tax laws, but that the

marketplace facilitators are the actual "retailers" required to collect the sales tax, this

the South Dakota template to ensure enforcement without resistance, given that the Court has already blessed this statute.

Potential for States to Add More Virtual Nexus Provisions as Well? Justice Kennedy reminded us all that the *Quill* Court, in removing the physical presence requirement from the Due Process nexus standard, stated that physical presence "'frequently will enhance' a business' connection with a State." In addition to economic nexus provisions, states may also continue to adopt virtual presence nexus standards under which a physical presence is established in a state by virtue of "cookies" installed on a customer's computer by a remote seller, by virtue of data stored on a third-party server or network of servers, or by virtue of allowing a customer to remotely access licensed software that the customer uses on their computer in the selling state. Such implications will serve to redundantly bolster a state's assertion of "economic nexus" over a remote seller, further minimizing constitutional challenges to state nexus laws.

What Should Remote Sellers Do: More detail was included above, but regardless, remote sellers should not rush out and register in every state in which they have sales. There will be a period of acclimation. Taxpayers, states and legal scholars will have to dissect the Court's *Wayfair* opinion to realize its practical implications, and then, ideally, states will need to legislatively or administratively adopt principles by which they seek to require remote sellers to collect sales tax. This may take several months, as states consider whether their existing nexus standards are potent enough to assert nexus and withstand constitutional scrutiny, or amend their laws or rules. We can, however, expect that some states will seek to simply issue a bulletin and/or mass mailing, simply informing remote sellers that they are now required to register and collect sales tax. Bolstered by this win, we can also expect states to increase audit enforcement of their existing nexus provisions, even without legislative or administrative change.

As such, it is incumbent on taxpayers to begin considering (1) historical sales by state, (2) nexus creating activities under existing state nexus provisions, (3) register where they determine nexus exists or the risk of nexus is material, (4) resolve any historical exposure proactively (and anonymously through Voluntary Disclosure Agreements), (5) implement sales tax compliance software solutions and processes, and (6) implement processes for tracking sales activity to determine when they exceed sales thresholds in states that adopt economic nexus standards. These multistate nexus provisions may create multistate sales tax compliance obligations for them now and potentially for prior periods, even before States begin to act.

POSTSCRIPT: POTENTIAL FOR CONGRESSIONAL ACTION? DON'T HOLD YOUR BREATH

There are currently several pieces of legislation before Congress that address many of these issues, and such legislation can be enhanced by the Supreme Court's *Wayfair* decision.

The Senate and the House continue to pursue legislative measures to enable states to impose sales tax collection obligations on out-of-state retailers, regardless whether they maintain a "physical presence." [Marketplace Fairness Act (S.976); Remote Transaction Parity Act (HR 2193)] In the Senate, since 2013, several legislators presented versions of the Marketplace Fairness Act (MFA), most recently in 2017, which would give states more power to collect sales taxes from businesses that don't have a physical location within their borders, so long as the state participates in the Streamlined Sales Tax Project or implements the simplification requirements and liability provisions of the MFA.

Its earliest version (The Marketplace Fairness Act of 2013) passed with ease in the

Project, or implements the simplification requirements and liability provisions of the RTPA. Like its Senate sibling, the RTPA is completely voluntary for states, provides a small seller exception and would require a minimum six-month waiting period before a state can begin requiring remote sellers to collect sales tax.

However, there are several notable differences between the MFA and the RTPA, including the size and applicability of the small seller exception, as well as potential audit liability for remote sellers and potential audit liability for sales tax automation solution providers. There are many unanswered questions in both versions as well. This includes, for example, liability of a remote seller to a customer for over- or under-collection of sales tax, how the legislation applies to remote sellers in foreign countries, whether state or federal courts have jurisdiction over cases involving administration of state taxes under these laws, penalties for noncompliance, and the lack of uniformity in tax treatment of products and services among state participating in the Streamlined Sales Tax Project.

To the extent Congress does respond to the Court's *Wayfair* decision, the manner in which Congress responds could cause more harm than good if Congress overreacts to the *Quill* reversal. If Congress enacts legislation that grants states too much authority to tax interstate commerce, it will open the floodgates to state taxation in a manner that cedes too much of its Commerce Clause power to the states. If Congress enacts legislation that is too restrictive or imposes too high of a small seller exemption, states may not realize sufficient sales tax revenues associated with remote sellers, and may begin the post-*Quill* aggressive tactics all over again.

As such, it is the author's opinion that Congress will do nothing while it waits to see how the states and taxpayers respond to the *Wayfair* decision. This may take several years to flesh out. Again, this obviates the necessity for taxpayers to begin considering the multistate nexus provisions that may create multistate sales tax

compliance obligations for them now and in the immediate future, even before states

Sales Tax

CPA Practice Advisor is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors.