

No Sales Tax on E-commerce Sales...Guess Again...

MORE STATES IMPOSE SALES TAX ON E-COMMERCE SALES

Introduction

Over the last few decades, states have had the opportunity to broaden their *income* and *franchise* tax base by ensnaring a larger proportion of out-of-state taxpayers in their taxing regime through adoption of broad economic or factor-based economic nexus standards.

However, states have traditionally struggled to do the same with respect to their *sales* and *use* tax base because of the long-standing United States Supreme Court nexus decision in *Quill Corp. v. North Dakota* (1992).¹ For nearly three decades, the dicta contained in *Quill* have prevented states from adopting economic-based nexus standards with respect to sales and use taxes, requiring instead a more stringent *physical* presence standard (or “substantial nexus”).

The Supreme Court has repeatedly declined to hear challenges or cases related to *Quill*, until recently. On January 12, 2018, the Supreme Court granted South Dakota’s petition for a writ of certiorari filed in *South Dakota v. Wayfair* (2018)², thus agreeing to revisit the landmark sales and use tax ruling which established that a state may not impose sales tax on out-of-state sellers of tangible personal property that have no physical presence within the state.

The Court’s decision in *Wayfair* is likely to bring clarity on nexus and filing requirements for many interested parties, especially those operating in the e-commerce industry.

Historical Background and Overview of Quill

Quill Corporation, a retailer of office supplies and stationary, sold its products to customers in North Dakota via mail-order catalogs and flyers and shipped the products into the state via common carrier. Quill had no employees, inventory, real estate, or other physical presence in North Dakota.

The state’s attempt to impose use tax on Quill for sales made into the state was ultimately upheld by the North Dakota Supreme Court. On appeal, the U.S. Supreme Court reversed the decision by North Dakota, citing the proposition from the Dormant Commerce Clause that only the federal government has the right to regulate interstate commerce. The Court

¹ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

² *South Dakota v. Wayfair, Inc. et al.*, 2017 S.D. 56 (2017), cert. granted.

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SUBJECT

South Dakota v. Wayfair

TAX TYPE

*Sales and Use Tax –
Economic Nexus*

STATE IMPACTED

Various

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further held that an out-of-state retailer's deliveries of sales via common carrier into the state was insufficient to establish "substantial nexus" (i.e., physical presence) required to impose sales tax on a seller.

Evolution of Business and Sales and Use Taxes

With the advent and subsequent explosion of the internet and online commerce (commonly described as "e-commerce"), the business landscape has evolved beyond the factual circumstances originally considered in 1992 in the Supreme Court's decision in *Quill*. Gone are the days of mailing catalogs and floppy disks to customers and taking orders by phone, or having to rely on brick-and-mortar retail locations as the primary sales drivers. Taxpayers are no longer required to be physically present (and therefore not subject to sales and use tax collection) in any one state in order to avail themselves of the market therein.

With the continued growth of e-commerce, companies that have a physical presence in a state but make sales to customers in multiple states have gained a competitive advantage over the traditional brick-and-mortar retailers, and nearly all items that consumers traditionally purchased at brick-and-mortar stores have moved online. Recognizing this competitive disadvantage, traditional retailers have sought to reorganize their operations to limit their physical presence and have advocated for more fairness in the traditional sales and use tax scheme. This has motivated states to become more aggressive in expanding their reach through the imposition of remote seller reporting requirements and the narrowing of *Quill* through the imposition of revised nexus rules.

Remote Seller Reporting and Notification Regime

The states in **Table A** below have enacted remote seller reporting and notification regimes, whereby a remote seller making sales into the state must comply with various notice and reporting requirements despite having no physical presence in the state.³ The reporting rules generally require sellers to notify in-state customers of the taxability of their purchases and to provide various reports of sales to the state. Some states allow the seller the alternative of registering, collecting, and remitting tax to the state. As expected, many taxpayers have found the reporting requirements to be unduly burdensome and voluntarily elected to register for sales tax collection even without nexus.

Table A: Reporting and Notification

State	Requires Reporting	Requirement Description	May Collect Sales Tax In-Lieu
Colorado	Yes	Retailers that do not collect Colorado sales or use tax must report their sales made into the state.	Yes
Kentucky	Yes	Out-of-state retailers making sales of tangible personal property or digital property for use, storage, or consumption in Kentucky (that are not required	Yes

³ In *Direct Marketing Association v. Brohl*, 735 F.3d 904 (10th Cir. 2013), the U.S. Court of Appeals held that Colorado's notice and reporting requirements did not violate the dormant Commerce Clause because they did not discriminate against or unduly burden interstate commerce (i.e. the notice and reporting requirement is constitutional). It is unclear whether the U.S. Supreme Court will address this issue in *Wayfair*.

		to collect Kentucky use tax) must notify the purchaser of their obligation to report and pay Kentucky use tax directly the Department of Revenue.	
Louisiana	Maybe	A dealer who sells and delivers more than \$250 of tangible personal property or taxable services to Louisiana residents must provide a list of those sales to the Department of Revenue upon request .	NA
Oklahoma	Yes	Oklahoma requires out-of-state vendors with no nexus in the state to provide notices to customers that use tax is imposed.	Yes
Pennsylvania	Yes	Remote sellers, marketplace facilitators, and referrers who make sales of at least \$10,000 into Pennsylvania must file an election by March 1, 2018, opting either to comply with notice and reporting requirements, or begin collecting sales and use tax.	Yes
Rhode Island	Yes	For sales occurring on or after Aug. 17, 2017, certain retailers that do not collect sales tax on their sales into Rhode Island must notify their customers via various methods that they may owe use tax on their purchases.	Yes
South Dakota	Yes	Out-of-state retailer or online auction website that is not registered to collect and remit sales and use tax is required to notify South Dakota buyers that they must pay and report use tax on their taxable purchases of tangible personal property, services, and electronically transmitted products for use in the state.	Yes
Vermont	Yes	Effective July 1, 2017, each “noncollecting vendor” that sells into Vermont must notify Vermont purchasers that sales or use tax is due and, additionally, each noncollecting vendor that makes \$100,000 or more of sales into Vermont in the previous year must file with the department of taxes on or before January 31 of each year a report showing the total amount paid by the purchaser for Vermont purchases made from the noncollecting vendor in the previous calendar year.	Yes
Washington	Yes	Beginning January 1, 2018, marketplace facilitators and remote sellers with sales of \$10,000 or more to Washington consumers must either collect sales and use tax on sales to Washington consumers or follow the specific notice and reporting requirements explained on the Department’s website at dor.wa.gov/marketplacefairness .	Yes

Nexus Expansion and the Narrowing of *Quill*

States have moved aggressively to narrow the impact of *Quill* through various approaches such as affiliate and attributional nexus, “click-through” nexus, and most recently, economic nexus. Affiliate nexus presumes nexus for an out-of-state seller based on the physical presence of a parent or other affiliated corporation in the state. Though this concept has been rejected by some state courts, other states have implemented the affiliate nexus concept, asserting that the presence of an affiliated corporation creates nexus for the related out-of-state taxpayer. Similarly, attributional nexus presumes to attribute the nexus creating activities of an in-state seller to an out-of-state seller if a relationship of some sort is deemed to exist.

The “click-through” nexus concept, the progeny of New York State, establishes a presumption of nexus on an out-of-state seller if the out-of-state seller enters into an agreement with in-state contractors or other representatives to refer potential customers to the seller’s website in exchange for compensation.

The latest, and arguably the boldest, effort by states to expand their sales and use tax reach has been the move to a broad-based economic nexus standard over the last two years. Arguably, this shift represents an effort by states to force the hand of the United States Supreme Court to finally acknowledge the issues posed by *Quill*. The economic nexus standards imposed by some states entirely defy *Quill* by requiring out-of-state sellers with no physical presence to collect and remit sales and use taxes if they are deemed to have a “substantial economic presence” in the state by way of exceeding a certain number of retail transactions in the state, or making sales of taxable tangible personal property into the state totaling a certain dollar value. At least one state has tied its economic nexus standard to the outcome of the *Wayfair* case. **Table B** below summarizes the states that have enacted some sort of economic nexus standard and provides a brief description of the mechanism by which nexus is deemed to be triggered.

Table B: Imposition of the Economic Nexus Standard

State	Economic Nexus	Description of Nexus Creating Activity	Dependent on <i>Wayfair</i> Decision
Alabama	Yes	Effective Jan. 1, 2016, Alabama expanded its sales tax jurisdiction to digital sellers with no in-state physical presence.	No
Connecticut	Yes	In early 2017, the Connecticut Department of Revenue Services released a statement indicating that it will pursue out-of-state sellers that have a substantial economic presence in the state.	No
Indiana	Yes	Effective July 1, 2017, a retail merchant without physical presence in Indiana will be found to be engaged in business in Indiana and therefore required to collect and remit the gross retail tax on retail transactions made in Indiana if a minimum volume of sales are made within Indiana.	No
Maine	Yes	On June 21, 2017, the Maine legislature took steps to enact an economic nexus standard for the state's sales and use tax.	No
Massachusetts	Yes	The state provides that certain internet vendors located outside of Massachusetts who make sales of tangible personal property or services in Massachusetts in excess of \$500,000 and who make such sales for delivery in Massachusetts in at least 100 transactions have nexus in Massachusetts if the vendor has certain software or hardware in the state.	No
Mississippi	Yes	Effective Dec. 1, 2017, sellers who lack physical presence nexus in Mississippi but who are purposefully or systematically exploiting the Mississippi market have a substantial economic presence for use tax purposes if their sales into the state exceed \$250,000 for the prior twelve months. Such sellers must collect tax on sales into Mississippi.	No
North Dakota	Yes	North Dakota has enacted an economic nexus provision, which would become effective should the United States Supreme Court overturn <i>Quill</i> or issue a decision confirming another state's economic nexus provision.	Yes
Pennsylvania	Yes	Remote sellers, marketplace facilitators, and referrers who make sales of taxable tangible personal property into the state totaling \$10,000 or more are required to file an election by March 1, 2018, to either begin to collect sales and use tax by April 1, 2018 or comply with the notification and reporting requirements.	No
Rhode Island	Yes	Rhode Island has enacted an economic nexus standard beginning Aug. 17, 2017.	No

South Dakota	Yes	South Dakota has enacted economic nexus legislation requiring sellers without a physical presence in the state to collect and remit sales tax if a minimum volume of sales are made within South Dakota.	No
Tennessee	Suspended	While enforcement of economic nexus provisions is suspended as of April 10, 2017, effective January 1, 2017, the state's regulation dictates that substantial nexus is established in Tennessee if an out-of-state dealer has physical presence within the state <i>or</i> if the out-of-state dealer has engaged in the regular or systematic solicitation of consumers in Tennessee and makes sales that exceed \$500,000 to consumers in Tennessee during the previous 12-month period.	Unknown
Wyoming	Yes	Wyoming has passed legislation imposing sales and use tax nexus on out-of-state retailers who lack physical presence with the state, but meet a certain threshold for revenue or volume of sales in Wyoming.	No

Recommendations

States With Remote Seller and Notification Requirements

The remote seller reporting and notification requirements enacted by various taxing jurisdictions have so far been deemed to be constitutional upon challenge. It is unknown at this time whether the United States Supreme Court will further address the constitutionality of this reporting regime in the *Wayfair* case. Taxpayers should evaluate their sales into the various jurisdictions to understand whether they may be subject to reporting and notification requirements.

To illustrate, Colorado's use tax notification requirements, effective July 1, 2017, require each retailer that does not collect Colorado sales tax and has gross sales into Colorado of \$100,000 or more in a calendar year to follow the notification and reporting requirements for that calendar year. Retailers that made less than \$100,000 in gross sales into Colorado in the prior calendar year or retailers that sell exempt goods to Colorado purchasers are not affected.

Retailers that meet Colorado's notification and reporting requirements have two notification requirements to Colorado customers and one reporting requirement to the State of Colorado. The notification requirements to Colorado customers are as follows:

1. At the time of purchase, they must provide a **Transactional Notice** to Colorado customers, informing them that the retailer has not paid Colorado state sales taxes on the item(s) being purchased and the customer may have a tax obligation to the state. The state provides a sample Transactional Notice that retailers may choose to use.
2. Non-collecting retailers must provide an **Annual Purchase Summary** to each Colorado customer by January 31 of the following year. This notification should be an end-of-year summary of purchases from the non-collecting retailer to assist Colorado customers in filing their tax returns. The state provides a sample Annual Purchase Summary that retailers may choose to use.

Retailers must also file an **Annual Customer Information Report** for each purchaser to the Colorado Department of Revenue showing the total amount paid for Colorado purchases of such purchasers during the preceding calendar year before March 1 of each year.



Failure to provide a Transactional Notice will subject the retailer to a penalty of \$5 for each such failure unless the retailer shows reasonable cause for such failure (the penalty is per transaction). Failure to send the Annual Purchase Summary notification to purchasers will subject the retailer to a penalty of \$10 for each failure (per customer) unless the retailer shows reasonable cause for such failure. And finally, failure to file the Annual Customer Information Report to Colorado will subject the retailer to a penalty of \$10 for each purchaser that should have been included in the annual statement, unless the retailer shows reasonable cause for such failure.

As previously discussed, the reporting and notification regimes imposed by the various jurisdictions may be cumbersome and costly, and as such, we recommend that taxpayers should evaluate the cost-benefit of complying with the reporting requirements versus choosing to voluntarily collect sales tax on all sales to customers in that state.

States With Economic Nexus Standard

With respect to the economic nexus standards imposed by some states that do not impose a reporting and notification regime, we recommend that taxpayers evaluate their sales into the various jurisdictions to understand whether the established dollar threshold amounts have been satisfied and thus creating a requirement to collect and remit sales and use tax. To the extent taxpayers have exposure, HCVT can assist in providing practical solutions.

Lastly, although it may be reasonable to speculate that *Wayfair* will overturn and replace *Quill*, it is unclear at this time what boundaries, if any, the Court may set for states with respect to imposing their sales and use tax regime. The Court is set to hear oral arguments on April 17, 2018.

If you have any questions on *Quill*, *Wayfair*, prospective strategy, or the reporting and notification regimes, please feel free contact any of the listed HCVT state tax professionals.