

# **Federation of Tax Administrators**

## **2016 Annual Meeting**

**Tuesday, June 14, 2016**

**Annapolis, Maryland**



## **Brave New World for *Quill*?**

Andy Gerlach, Secretary, South Dakota

Steve Kranz, Partner, McDermott, Will & Emery

Julie Magee, Commissioner, Alabama

Fred Nicely, Sr. Tax Counsel, COST

# Agenda

- Brief History – *Quill*'s Physical Presence Std.
- Overview – States' Nexus Expansion Efforts
- NCSL's Call to Act
- South Dakota's Approach
- Alabama's Approach
- Other State Nexus Cases
- Federal Solutions
- Outlook

# Brief History

# Brief History – Pre-*Quill*

- **1967:** *National Bellas Hess*
  - Supreme Court determined physical presence is required
- **1973:** Congress introduces legislation to overturn *National Bellas Hess*
  - Interstate Sales and Use Tax Act (HR 1453; S. 282)
- **1980's:** MTC coordinates with states to take the position that physical presence is not required
  - Theory: advances in technology had alleviated the administrative burdens justifying *National Bellas Hess*

# ***Quill Corp. v. N. Dakota***

## **504 U.S. 298 (1992)**

- Distinguished the two constitutional nexus standards.
  - A person may have Due Process “minimum contacts” with a state, yet still lack the “substantial nexus” with the state that the Commerce Clause requires.
- Physical presence in state required for business to have “substantial nexus” with taxing state under the Commerce Clause.
  - Many courts have held that the this standard is limited to the sales and use tax context.

# How “Physical” Must a Remote Seller’s Presence Be?

- **1960:** *Scripto*
  - Does not matter if solicit as an employee or as an independent contractor
- **1977:** *Nat’l Geographic*
  - Physical presence unrelated to making a sale is still sufficient to impose collection obligation
- **1987:** *Tyler Pipe*
  - Are activities performed in the state on behalf of the taxpayer significantly associated with taxpayer’s ability to establish and maintain a market?

# Overview of States' Nexus Expansion Efforts

# 2016 State Legislative Update

- Disgruntled with the unwillingness of Congress to take action, many states have started to act as if *Quill* no longer applies.
- This legislative trend continued in full force during the 2016 state sessions.
- **Over 50 bills** expanding the nexus and reporting requirements have been introduced in **20 different states** in 2016.



# States' Nexus Expansion Efforts

- Attributional/Affiliate Nexus Legislation
- Click-through Nexus Legislation
- Notice and Information Reporting Requirements
- “*Quill* is Dead” Legislation
- Marketplace Provider Proposals
- Economic Nexus

# Affiliate/Attributional Nexus

- Taxpayers with related entities [in similar businesses] creates nexus for all affiliates.
  - Usually a rebuttable presumption.
- 40 states have affiliate nexus provisions.
  - Some only apply if in-state affiliate maintains a warehouse or distribution facility in the state.
  - Others apply if the in-state affiliate:
    - Sells the same or similar products;
    - Uses trademarks or trade names that are the same or similar to those of the retailer; or
    - Conducts any other activities significantly associated with the retailer's ability to establish and maintain a market in the state.

# Affiliate/Attributional Nexus

- Other states have taken the position that constitutional nexus precedent supports the use of affiliate nexus.
- *See, e.g., N.M. Taxation & Revenue Dep't v. BarnesandNoble.com, LLC*, 303 P.3d 824 (N.M. 2013).
  - The New Mexico Supreme Court ruled that the taxpayer, an online retailer with no physical presence in New Mexico, had substantial nexus with the state through the taxpayer's sister corporation, which did have a physical presence in the state.
  - The sister corporation: (1) displayed the taxpayer's website in its in-state retail stores, (2) shared the same trademark with the taxpayer, and (3) engaged in cross-marketing activities for the taxpayer's benefit, all of which maintained the taxpayer's market in New Mexico.

# 2016 State Legislative Update

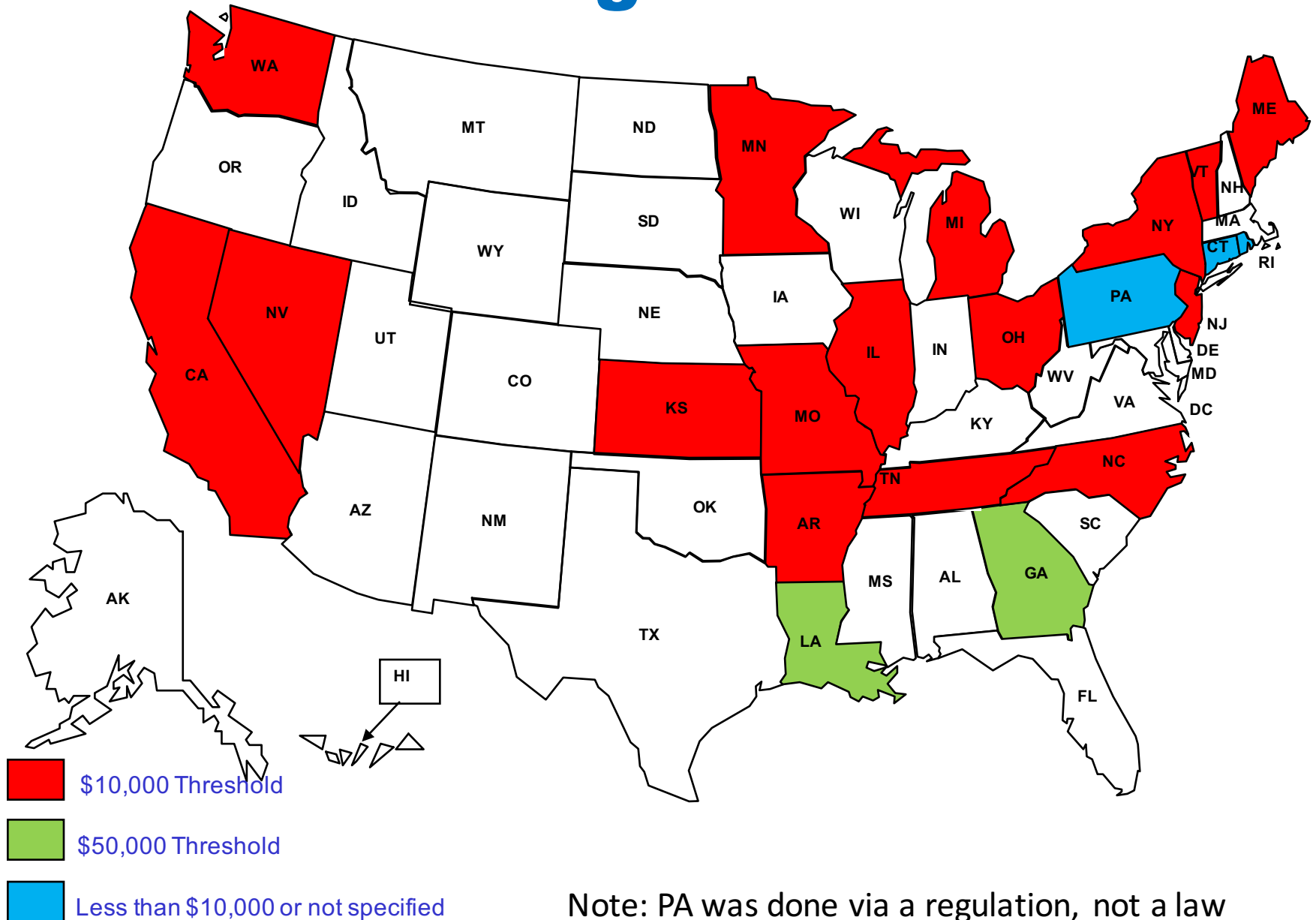
## Affiliate Nexus

- **19 bills** introduced in **8 states**:
  - Idaho - HB 581, HB 633
  - Louisiana - HB 6, HB 30, HB 96, HB 110
  - Massachusetts - S 1618
  - Minnesota - HF 2769, SF 2374, HF 3124, SF 3093, HF 3787, HF 848
  - Nebraska - LB 1087
  - Oklahoma - HB 2531, HB 2925
  - Rhode Island - H 7375
  - Utah - SB 182, HB 235
- LA (HB 30) and OK (HB 2531) enacted affiliate nexus legislation this year.

# Click-Through Nexus

- First adopted by New York in 2008 and at least 18 additional states since then.
- In-state website operators create a sales tax collection obligation (or rebuttable presumption) for remote sellers if operators in the state collectively refer a threshold amount of sales to the remote seller through links on their websites.

# Click-Through Nexus Laws



Note: PA was done via a regulation, not a law

# 2016 State Legislative Update

## Click-Through Nexus

- **12 bills** introduced in **5 states**:
  - Idaho - HB 581, HB 633
  - Louisiana - HB 6, HB 30, HB 96, HB 110
  - Nebraska - LB 1087
  - Rhode Island - H 7230, H 7375
  - Utah - SB 85, SB 182, HB 235
- Louisiana HB 30 was enacted in March.

# Click-Through Nexus

- *Overstock.com, Inc. v. New York State Department of Taxation and Finance*, 20 N.Y.3d 586 (N.Y. 2013).
  - The New York Court of Appeals upheld the New York click-through law as facially constitutional.
  - The law was upheld, in large part, because it was not an absolute rule but rather a rebuttable evidentiary presumption.
  - The United States Supreme Court denied cert on December 2, 2013.
- Compare *Performance Marketing Ass'n v. Hamer*, 998 N.E.2d 54 (Ill. Sup. Ct. Oct. 18, 2013).
  - Illinois' former click-through law was absolute (not a rebuttable presumption).
  - Violated Internet Tax Freedom Act (ITFA) because it imposed discriminatory tax on electronic commerce.
  - Did not address the Commerce Clause challenge.



# Use Tax Notice and Information Reporting Requirements

- **2010:** Colorado was the first state to impose.
- The enacting legislation started as a click-through bill (similar to New York), but was modified during the legislative process.
- Requires retailers to:
  - (1) notify Colorado purchasers that tax is due on their purchases;
  - (2) send annual notices to Colorado customers who purchased more than \$500 in goods in the preceding year, “reminding” these purchasers of their obligation to pay sales tax to the state; and
  - (3) report information on Colorado purchasers to the state’s tax authorities. See Colo. Rev. Stat. § 39-21-112(3.5).
- Prior to 2016, only 7 states enacted these provisions.
  - Colorado was the only state that had penalty provisions.

# Use Tax Notice and Information Reporting Requirements

**Feb. 22, 2016 – *DMA v. Brohl*, 814 F.3d 1129 (10th Cir. 2016)**

- 10<sup>th</sup> Circuit issued decision on remand from Supreme Court
  - *Quill* physical presence requirement is limited to tax collection.
  - “*Complete Auto* does not apply here because this case involves a reporting requirement and not a tax.”
- Petition for *en banc* rehearing denied April 1.
- Cert petition to U.S. Supreme Court or extension request due by June 30, 2016.

# 2016 State Legislative Update

## Notice and Reporting

- **18 bills** introduced in **8 states**:
  - Iowa - HF 2319
  - Kansas - HB 2603
  - Louisiana - HB 110, HB 113, HB 294, HB 295, HB 1037, HB 1121
  - Minnesota - SF 3093, HF 3124, HF 2769, SF 2374
  - Oklahoma - SB 1301, HB 2531
  - Rhode Island - H 7375
  - Utah - SB 65
  - Vermont - H 753, H 873
- OK HB 2531 and VT H 873 were enacted in May.

# ***“Quill is Dead”* Legislation**

- In 2010, Oklahoma passed legislation that listed all of the steps it had taken to simplify its sales and use tax system, and declared that its tax system no longer presented an “undue burden” on interstate commerce and that any and all remote sellers are required to collect sales and use tax on sales made into the state.
  - See 68 Okla. Stat. § 1407.5.

# Marketplace Provider Proposals

- In 2015, several states proposed provisions that would impose burdens on marketplaces related to remote sales made through the marketplaces.
  - **New York** and **Washington** proposed legislation that would have required marketplace providers to collect sales and use tax on sales made through the marketplaces (regardless of whether the seller was registered for sales tax in the state).
  - **Utah** and **South Dakota** proposed information reporting requirements for marketplaces, requiring them to report the identity and contact information of remote sellers making sales into the state through the marketplace.
  - **Wisconsin** enacted legislation exempting certain marketplace providers that have a distribution center in the state – presumably asserting other marketplace providers with nexus in Wisconsin must collect the tax on 3<sup>rd</sup> party sales.

# 2016 State Legislative Update

## Marketplace Providers

- **14 bills** introduced in **7 states**:
  - Louisiana - HB 110, HB 113, HB 294 (reporting only)
  - Minnesota - HF 2769, SF 2374, HF 3124, SF 3093, HF 848
  - Mississippi - SB 2052, HB 418
  - Nebraska - LB 1087
  - Oklahoma - HB 2531
  - Rhode Island - H 7375
  - Utah - SB 65 (reporting only)
- MN (HF 848) passed a marketplace provider imposition (delayed effective date).

# NCSL's Call to Act

# U.S. Supreme Court Justice Opines

Justice Kennedy's Concurrence in *DMA v. Brohl* (2015):

- “The legal system should find an appropriate case for this Court to reexamine *Quill* and *Bellas Hess*”



# NCSL's Call to Act

- On Jan. 20, 2016, the NCSL issued a letter to state legislatures urging them to act with haste to expand state statutory authority to collect sales tax.
- Accompanying the letter, the NCSL distributed draft state legislative language designed for the specific purpose of overturning *Quill*.

# NCSL's Call to Act (cont.)

- NCSL draft language includes:
  - Legislative Findings (from 2015 Washington legislation)
  - Nexus Expansion provisions to expand scope of “doing business”
    - Affiliate/attributional nexus, click-through nexus, economic nexus
  - Marketplace Sales Tax Collection
  - Marketplace Use Tax Reporting and Registration Requirements (Referrer)
    - Both reporting to state and notice to customers
  - Direct Appeal to State Supreme Court to accelerate litigation
  - Fixed future effective date (to avoid retroactivity concerns cited in *Quill*)

# **2016 State Legislative Update**

## **Economic Nexus**

- **10 bills** introduced in **8 states**:
  - Connecticut - SB 448
  - Louisiana - HB 110
  - Minnesota - HF 3787, SF 3441
  - Nebraska - LB 1087
  - Oklahoma – SB 1251, SB 1301
  - Rhode Island - H 7375
  - South Dakota - SB 106
  - Vermont – H 873
- The SD and VT bills were enacted.

# South Dakota's Approach



South Dakota's Remote Seller's Sales Tax Law

# SB 106

Andy Gerlach, Secretary

# Timeline

- Discussion about potential legislation establishing a threshold for remote seller sales tax requirement in South Dakota.

December

January

- A bill is drafted establishing remote seller requirements; eventually becoming SB106

March 22

- Gov. Dennis Daugaard signs SB 106 into law with an effective date of May 1, 2016.

March-April

- SB 106 is prepared to be implemented

April 28-29

- Legal action associated with SB 106 takes place



# Senate Bill 106 Background

December

- Inability to collect sales tax from remote sellers threatens South Dakota's efforts to sustain a broad tax system, which allows South Dakota to keep taxes low.
- Because South Dakota doesn't have a state income tax, sales and use tax revenue are essential in funding state and local services.
- The growth of online retail ensures further erosion to our sales tax base.

## Remote Sellers must remit South Dakota sales tax if they meet one of two criteria

January

- The seller's gross revenue exceeds \$100,000.
  - The sellers made 200 or more separate transactions into South Dakota.
- 
- Any sales tax obligation required by this act cannot be applied to past sales.





# Senate Bill 106 Background

January

- State Governments
- Multi-State Tax Commission (MTC)
- South Dakota Retailers Association (SDRA)
- Retail Industry Leaders Association (RILA)

*"These entities contend that South Dakota is the 'ideal' target state for this legislation."*

Knowing this will take a long time...

March-  
April

- Developing a sound and fair legislative bill
- SDDOR identified 200+ companies who meet one or both of the remote seller sales tax requirements
  - Accomplished through past audit information
- Staff training
- Media education and talking points



April 28-  
29

- On April 28, 2016, the State of South Dakota filed a declaratory judgment action in the Sixth Judicial Circuit Court, Hughes County, against four remote sellers: Newegg, Overstock, Systemax, Wayfair.
- On April 29, American Catalog Mailers and NetChoice filed a declaratory judgment action against me in the Sixth Judicial Circuit Court, Hughes County.

March-  
April



- DOR sent 206 letters on March 25 to those most likely to meet one of the two remote seller requirements
- The letters explained the two criteria and how the companies can apply for a South Dakota Sales Tax License.
- DOR also created a new webpage with this information, which had more than 1,700 visits in April and May, alone.



March-  
April

- After the letters were sent, 108 remote sellers applied for licenses, 82 of which have been issued.
- 38 of the applicants applied as a result of receiving DOR's letter.

- *State of South Dakota v. Wayfair INC, Systemax INC, Overstock.com INC, Newegg INC*
  - On May 25, the defendants moved the case from State Circuit court to the United States District court, District of South Dakota, Central Division.
- *American Catalog Mailers Association and Netchoice v. Andy Gerlach*
  - Venued in South Dakota's Sixth Judicial Circuit in Hughes Co., South Dakota.



***For more information, visit***

- [http://dor.sd.gov/Taxes/Business\\_Taxes/SB106.aspx](http://dor.sd.gov/Taxes/Business_Taxes/SB106.aspx)

# **The Movement to Overturn *Quill*: An Alabama Update**

**Commissioner Julie P. Magee, Alabama Department of  
Revenue**



# Alabama Background

## **Where we were just over one year ago - spring of 2015**

- Bentley Administration had already identified remote sales / use tax collection as a priority
  - Raises revenue without raising taxes
- Traditional sales tax base is eroding
- Local brick and mortar retailers, some of our most important partners in the tax collection process, are suffering at the hands of online and untaxed competition
- Congressional inaction – From Streamlined to Marketplace Fairness to Goodlatte origin sourcing.....states are losing hope

## **From this environment comes Justice Kennedy's concurrence**

- Viewed as an invitation for state action

# **Alabama's Response to Kennedy's Concurrence in DMA**

- **After reading an article on Kennedy's concurrence I asked my staff for a plan**
- **We decided to do two things:**
  - **Simplified Sellers Use Tax System**
  - **Economic Nexus Rule for Large Remote Sellers**

# **Alabama's Response to Kennedy's Concurrence in DMA**

## **Simplified Sellers Use Tax Remittance Act**

- Repositioned Alabama from being one of the most difficult states for remote sales tax collection to one of the easiest
- One return filed with ADOR
- One rate for state and local use tax – 8%
- One audit
- 2% discount for participants

# **Alabama's Response to Kennedy's Concurrence in DMA**

## **Sales Tax Economic Nexus Regulation**

- Rule 810-6-2-.90.03
- Effective Jan. 1, 2016, remote sellers with a substantial economic presence in Alabama are required to collect and remit Alabama tax and file returns regardless of whether seller has a physical presence
- \$250,000 in sales in Alabama equals substantial economic presence
- Remote sellers may comply with rule by participating in the Simplified Sellers Use Tax Remittance Program

# **Alabama Litigation**

## **Newegg Inc., v. Magee**

- **Docket # S.16-613**
- **Filed June 9 (last week) with the Alabama Tax Tribunal**
- **Challenges the Constitutionality of Alabama economic nexus rule**

# **The Success of Alabama's Simplified System**


## **Amazon**

- **Amazon will start collecting Alabama tax effective November 1, 2016**
- **Amazon motivated by a combination of our new simple system and Amazon's expanding footprint**
- **Amazon 2015 sales = more than \$100 Billion**

# The Success of Alabama's Simplified System

- 45 remote sellers participating in the program
- Total revenue collected through the program to date: \$1,516,678 (see chart for monthly breakdown)
- Agreements have been reached with several large remote sellers that are participating in the program or will be very soon
- While we are moving forward with litigation to overturn *Quill*, we are already well over half way to achieving complete remote sales tax collection because of the success of our simplified system and our regulation

## ▶ Collections by Month

- 
- ▶ November  
\$3,929
  - ▶ December  
\$8,641
  - ▶ January  
\$36,858
  - ▶ February  
\$61,235
  - ▶ March  
\$371,207
  - ▶ April  
\$514,765
  - ▶ May  
\$520,043

# Lessons we are learning

- **If you build it, they will come**
  - Much of the remote sales / online retailer industry is ready to put the sales tax collection issue behind them and get on with their business
- **Congress is stuck - the states and industry must change the paradigm before Congress will act**
  - Overturning *Quill* (maybe the threat of overturning Quill) may be what changes the paradigm
- **Virtually no one believes physical presence makes sense today**
  - Even our critics don't defend physical presence
- **Actions speak louder than words**



# Other State Nexus Cases

# Current/Future Litigation

## Ohio CAT Cases

- There are three companion cases pending before the Ohio Supreme Court that involve the imposition of the Ohio Commercial Activity Tax (“CAT”).
  - The CAT is a gross receipts tax imposed on any business having receipts greater than \$250,000 from sales made into the state.
  - *See Crutchfield, Inc. v. Testa*, No. 2015-0386 (filed Mar. 6, 2015); *Newegg, Inc. v. Testa*, No. 2015-0483 (filed Mar. 25, 2015); *Mason Cos., Inc. v. Testa*, No. 2015-0794 (filed May 19, 2015).
- Oral arguments held on May 3, 2016.

# Federal Solutions

# Federal Legislation

- “No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. . . . Accordingly, **Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.**”
  - *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

# **Federal Legislation**

## **Overview of the Proposals**

**Since 2005, the following types of legislative bills have been introduced:**

- Main Street Fairness Acts (MSFA)
- Marketplace Equity Act (MEA)
- Marketplace Fairness Acts (MFA)
- Online Sales Simplification Act (draft only)

# **Federal Legislation**

## **Main Street Fairness Acts**

- Granted collection authority over remote sellers to Streamlined states in compliance with the Agreement.
- Required the states to provide the most simplification and uniformity of the proposals.
- Included a small seller exception.
- Allowed access to Court of Federal Claims to challenge Gov. Board action deemed arbitrary or capricious.

# **Federal Legislation**

## **Marketplace Equity Act**

- Granted collection authority over remote sellers to any state that meets the minimum simplification requirements.
- Minimal simplifications required by states:
  - No specific preference given to SSUTA states
  - No requirement for “free “software
  - Allowed states to pick one of three rates:
    - Blended tax rate
    - Highest tax rate
    - Destination tax rate
- Small seller exception anticipated to be \$1,000,000 in remote sales or less than \$100,000 in remote sales in a particular state.

# **Federal Legislation**

## **Marketplace Fairness Act**

- Passed Senate in 2013 (S. 743); re-introduced March 10, 2015 (S. 698).
- Provides a state two options for gaining the Congressional authorization to require remote sellers to collect sales tax:
  - (1) SSUTA member states have to provide 90 days notice that they will exercise authority under the Act; or
  - (2) Non-SSUTA members must comply with minimum simplification requirements.
- Permanent “small seller” exemption for remote sellers (less than \$1M in total gross receipts from remote sales during the preceding calendar year).



# **Federal Legislation**

## **Remote Transactions Parity Act**

- Introduced June 15, 2015 (H.R. 2775).
- Bi-partisan support in House, as of August 1 has 46 co-sponsors.
- Also provides states with two options for gaining Congressional authorization, similar to the MFA.
- Includes the minimum simplification requirements contained in the MFA, plus additional protections for remote sellers and certified software providers.

# Federal Legislation

## Remote Transactions Parity Act

- *De minimis* exception provided for any seller that has an in-state presence (i) for less than 15 days or (ii) to conduct limited or transient business activity.
- Does not preempt state law; there is no provision that nexus is changed under RTPA, it merely authorizes an imposition of tax in addition to the status quo.
- The “small remote seller” exemption phases out over a three-year period.

# Federal Legislation

## Online Sales Simplification Act

- Jan. 13, 2015 - House Judiciary Chairman Bob Goodlatte released a discussion draft.
  - Has not been introduced.
  - May 13, 2016 – section-by-section explanation of the proposal released by Chairman Goodlatte.
- The draft proposes a hybrid origin-based solution.
- Only “origin” states may impose a sales and use tax collection requirement on remote sellers.
  - States must join a distribution agreement (*i.e.*, Clearinghouse), whereby origin states redistribute the revenue to destination states.

# Outlook

# Outlook

- Uncertain future...
  - Will United States Supreme Court ultimately consider one of the direct challenges to *Quill* (i.e., South Dakota SB 106 suits)?
  - Will *DMA* (10th Cir.) or the Ohio CAT cases make it there first?
  - Will Congress feel the heat from the states and finally pass one of the federal remote sales tax bills?
  - Or, will Congress feel relieved and not act until the courts sort it all out?

# Outlook

- Predictions
  - Will a state court ignore *Quill*?
    - *James v. City of Boise*, 136 S.Ct 685 (2016) – “if state courts were permitted to disregard this Court’s rulings on federal law, the laws, the treaties and the constitution of the United States would be different in different states”
  - Will Congress act in its lame duck session this fall?
  - Will SCOTUS reverse *Quill*?
    - Retroactivity concerns?
    - Legislating from the bench concerns?

# Questions?

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