

From Quill to Wayfair (and Back?)

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AGENDA

- Wayfair Oral Arguments and Outcome
- Post-Wayfair: What Happens if Quill is Overturned?
- Post-Wayfair: What Happens if Quill is Upheld?

Wayfair Oral Arguments and Outcome

SB 106: Legal Action

State of South Dakota v. Wayfair INC., Overstock.com INC., and Newegg INC.



SB 106 passed and became law effective May 1, 2016.

SD Supreme Court Opinion issued on Sept. 13, 2017.



US Supreme Court granted certiorari on Jan. 12, 2018.

US Supreme Court heard oral arguments on April 17, 2018.



US Supreme Court Decision expected by end of June.

South Dakota *Wayfair* reply brief

- “This Court has never expanded on *Quill* or interpreted the contours of ‘physical’ presence. It can thus interpret that standard as broad enough to encompass the inescapable presence of internet retailers ‘via cell phones, tablets, and laptops’ that it had no opportunity to consider in 1992—largely limiting *Quill* to its mail-order holding.”

US Solicitor General's *Wayfair* brief

- “The Court should resolve this case by making clear that an out-of-state Internet retailer’s virtual presence within a State is a sufficient ground for requiring the retailer to collect sales or use taxes owed by its in-state customers. To establish that proposition, the Court need not disturb *Quill’s* holding that delivery of catalogs and goods by mail or common carrier is not by itself an adequate basis for imposing state-tax-collection duties”

Oral Arguments in Wayfair

- Panel Member Comments on oral arguments at SCOTUS
- Questions for the State
- Questions for the Taxpayer
- Surprises

Possible Outcomes

- Uphold *Quill*
- Overturn *Quill*
- Uphold South Dakota's laws
- Remand to South Dakota



Time to prepare is now.

You need to be thinking about what you are going to do (or not do).

Post-Wayfair: What Happens if Quill Is Overturned?

Post Wayfair: Overview of What Happens If Quill is Overturned

- New state compliance procedures to register remote sellers and facilitate compliance
- Positive impact on state tax revenues
- The retroactivity dilemma
 - Pressure on states to apply prospectively only?
- “Small business” / de minimis exception?
- Will the pressure on Congress or the states to make sales tax laws simpler and more uniform dissipate?
- Impact on nexus for other tax types (e.g. income tax, gross receipts tax)

Out-of-State Businesses

Steps for Implementing:

- Develop Uniform Implementation Date
 - Education - Customer Service
 - Notify of Requirements to Collect
 - Registration Process
 - Filing and Processing Returns
 - Compliance Efforts
-

In-State Businesses

Steps for Implementing:

- Education - Customer Service
- Dedicated Website Page for Centrally Located Information
- Provide Links to Other State's Departments of Revenue
- Communicate Proactively
- Partner with Key Stakeholders (State Retailer Association)

What Will Happen to Sales Tax Simplification Efforts?

- Over the last quarter century, the *Quill* decision established the scope of the debate over the fairness and efficiency of state sales taxes.
- By focusing on “burdens” imposed on interstate commerce, *Quill* linked a mandated collection responsibility for remote sellers (and thus a “level playing field” for bricks-and-mortar retailers) with sales tax simplification and uniformity.
- The U.S. Supreme Court may overturn the longstanding *Quill* precedent in the *Wayfair* case, but attaining a level of sales tax simplification that satisfies a constitutional “commerce clause” requirement should not be confused with constructing an efficient and fair modern-day sales tax system.

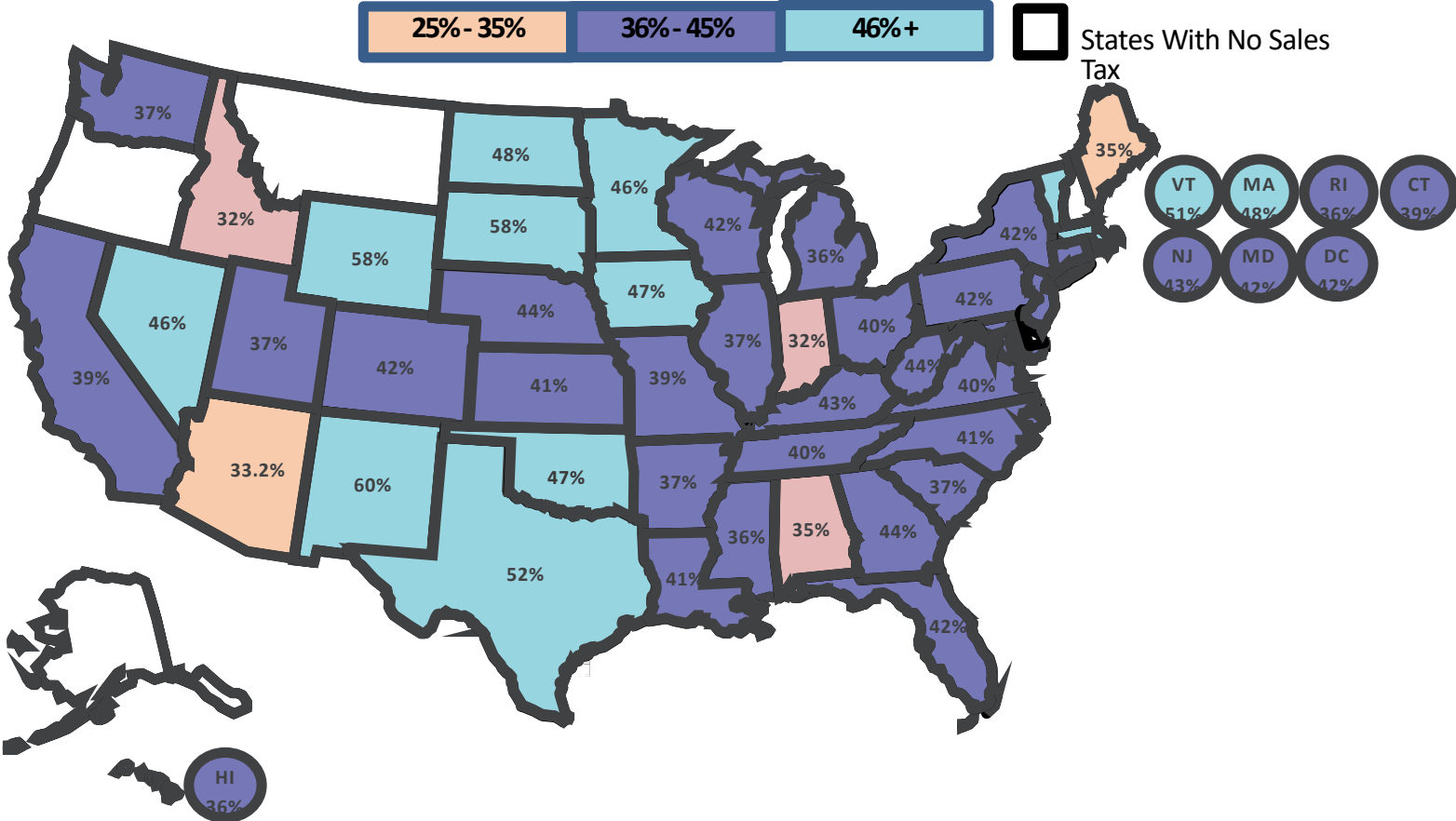
The U.S. Sales Tax Is One of the Most Complex and Inefficient Consumption Taxes in the World

- **Taxation of Business Inputs**
 - 42 percent of total sales tax revenue is from the taxation of business inputs – violating a basic principle that consumption taxes should tax final personal consumption and not pyramid the tax on business-to-business intermediate transactions.
- **Uniformity and Simplification**
 - While 24 states have adopted the Streamlined Sales and Use Tax Agreement (SSUTA), nearly two-thirds of the U.S. population live in sales tax states that have not adopted SSUTA.
 - The 6 largest states have still not joined SSUTA (California, Texas; Florida; NY; Illinois; Pennsylvania)
 - There have been only a handful of new SSUTA members over the last 10 years.

State and Local Sales Taxes Imposed on Business Inputs

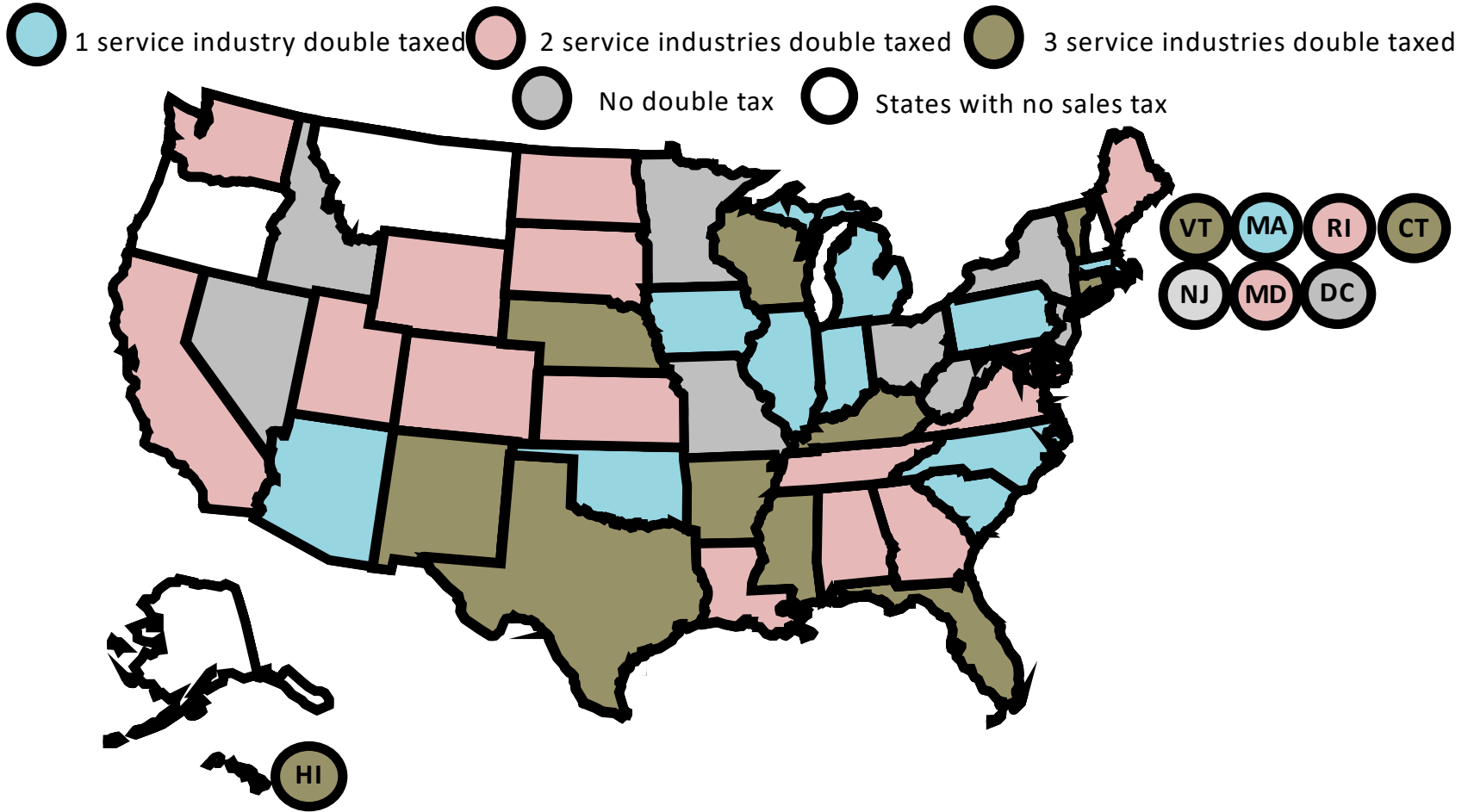
Business Inputs Share of Total Sales Tax Collected

Source: COST: The Best and Worst of Sales Tax Administration



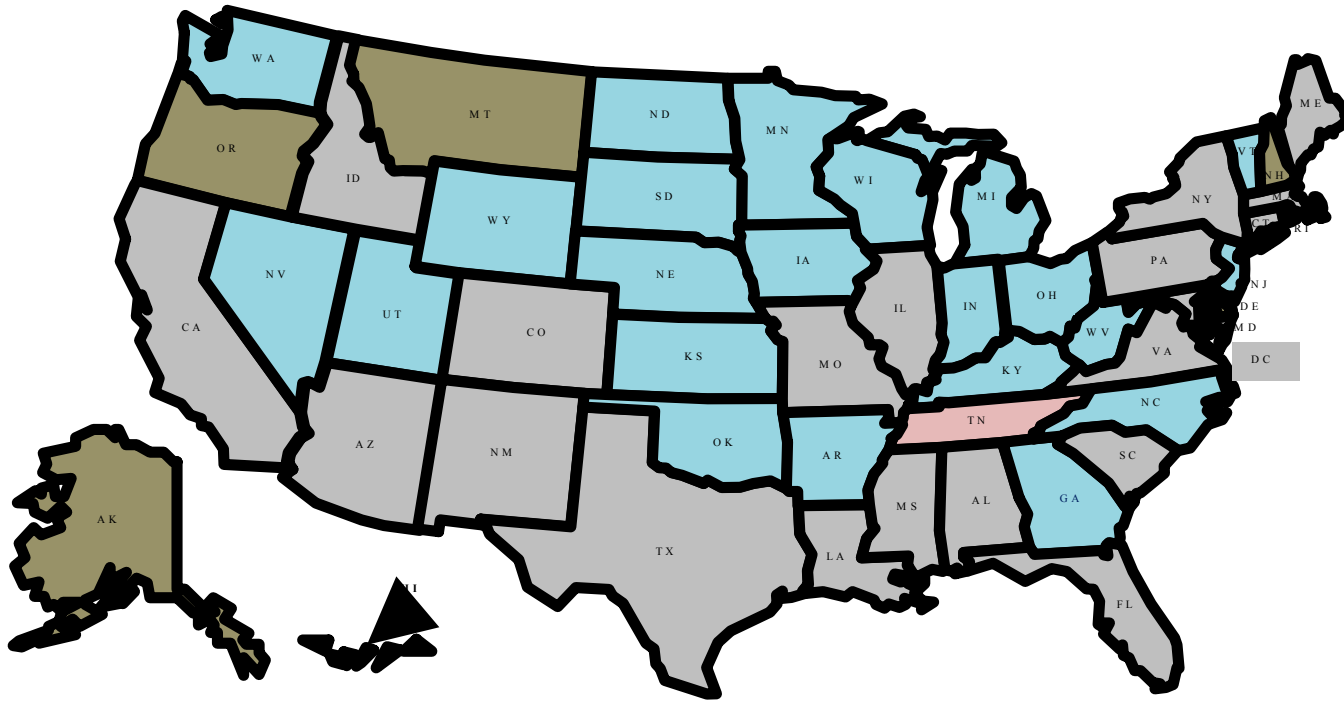
Double Taxation of Select Service Providers: Wired/Wireless, Cable, Electric + Gas

Source: COST: The Best and Worst of Sales Tax Administration



Streamlined Sales Tax States

● Full Member ● Associate Member ● Non-Sales Tax State ● Non-Member



The Complexity of the U.S. Sales Tax (Cont.)

- **Central Administration**

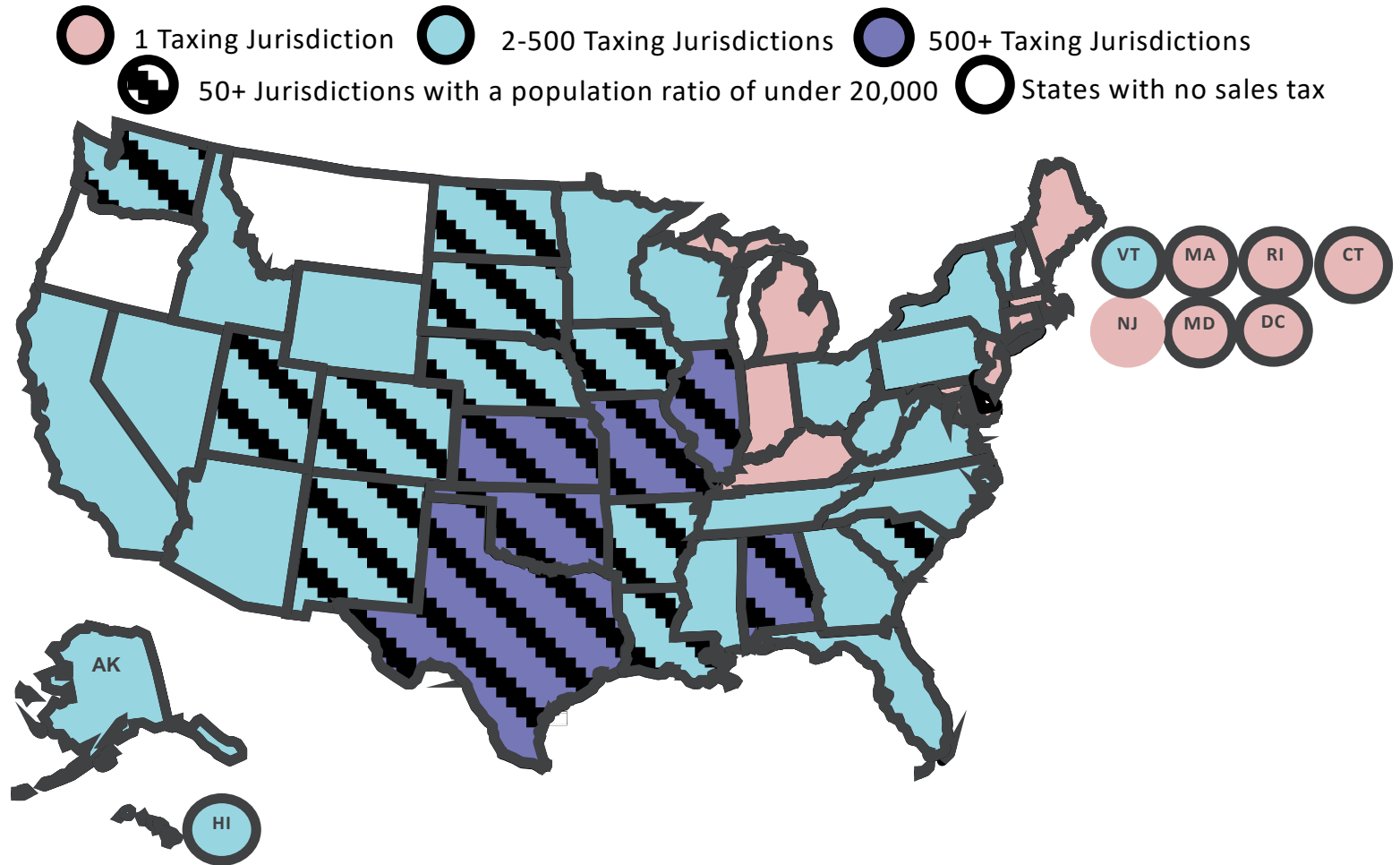
- The U.S. sales tax - with 45 state taxing jurisdictions (plus D.C.) and over 10,000 state and local taxing jurisdictions – is the most decentralized consumption tax in the world.

- **Reasonable Vendor Compensation**

- Most states provide little or no “vendor compensation” to reimburse sellers for the cost of collecting, remitting or refunding sales tax.
- According to a 2006 PwC study prepared for the Streamlined Sales Tax Governing Board, sellers incurred average compliance costs ranging from 13.47% for smaller sellers to 2.17% for large sellers.

Number of Taxing Jurisdictions

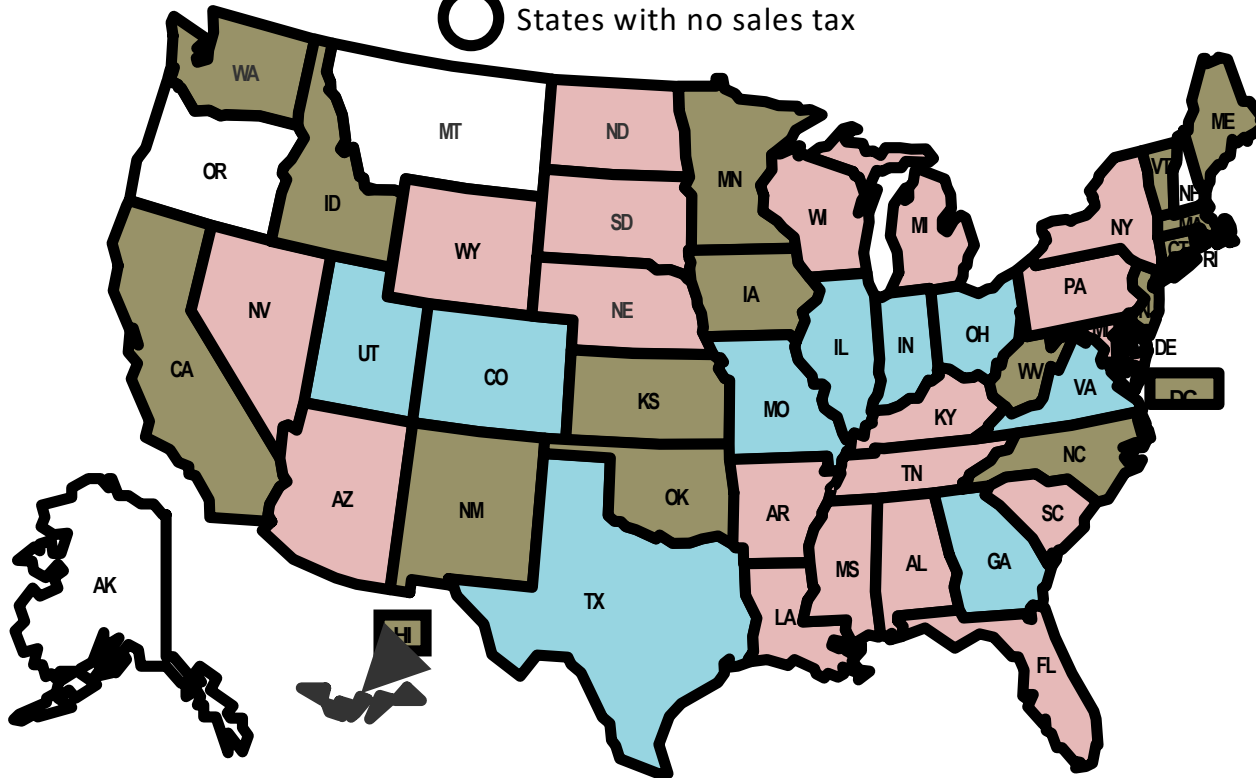
Source: COST: The Best and Worst of Sales Tax Administration



Vendor Compensation

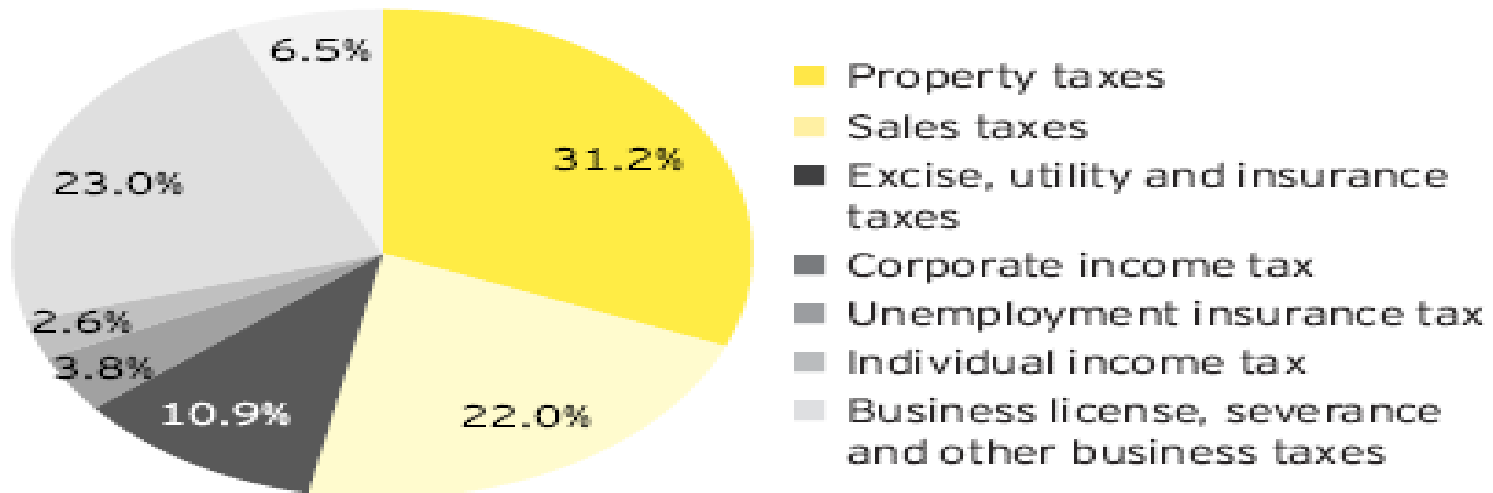
Source: COST: The Best and Worst of Sales Tax Administration

- Uncapped Vendor Comp.
- Limited or Capped Vendor Comp.
- No Vendor Comp.
- States with no sales tax



Sales Tax and Overall State & Local Revenue

Figure 1a: Composition of total state and local taxes on businesses and households, FY2016

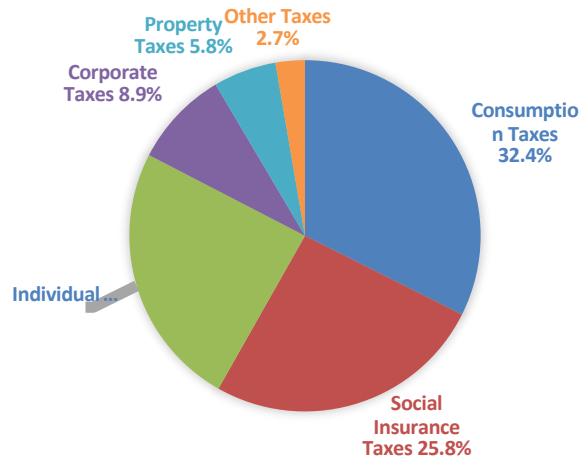


The U.S. Relies Much Less on Consumption Taxes than other Developed Nations

Share of Consumption Taxes: 32.4%

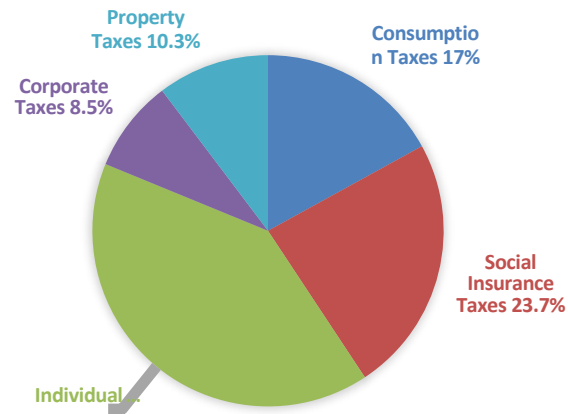
OECD vs. 17% U.S.

OECD Average Sources of Tax Revenue,
2015



Source: OECD.Stat, <http://stats.oecd.org/>

United States' Sources of Tax Revenue
(Federal, State, and Local, 2015)



Source: OECD.Stat, <http://stats.oecd.org/>

Post-Wayfair: What Happens if Quill is Upheld?

Post Wayfair: Overview of What Happens If Quill Is Upheld

- The conventional wisdom is always wrong. Few thought that SCOTUS would take the case. Once cert was accepted, few thought that SCOTUS might uphold the Quill principle that a physical presence is required for a vendor to have to collect sales/use tax.
- The Court seems troubled by the impact on small business and possible retroactive application.
- If the Quill principle is maintained, how will state attempts at workarounds like “notice and reporting” statutes and the Massachusetts “cookie nexus” approach develop?
- What about “marketplace provider” legislation; and the South Carolina litigation against Amazon arguing a “marketplace provider” should collect the sales tax as essentially the “online consignment store”?

Colorado-style notice and reporting requirements...

2010 Colorado enacts legislation requiring non-collecting remote retailers to

- Send transactional notice to Colorado purchasers that their purchase may be subject to Colorado use tax;
- Send annual purchase summaries to Colorado customers purchasing \$500 or more from the non-collecting retailer; and
- Send the DOR an annual customer information report, to include customer names, addresses, and total amount spent.

2016, the 10th Circuit decision – *Quill* physical presence rule only applies narrowly to sales and use tax collection and liability; not to regulatory measures like the Colorado reporting and notice requirements. Applying *Complete Auto* analysis, these measures do not violate dormant commerce clause. *Direct Mktg Ass'n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016).

States follow Colorado's lead...

13 other states* have enacted Colorado-style information reporting regimes or authorized the promulgation of notice and reporting rules for:

- Non-collecting retailers,
- Referrers, and/or
- Marketplace Facilitators

*Alabama, Connecticut, Georgia, Kentucky, Louisiana, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Tennessee, Vermont, and Washington

Oklahoma, Pennsylvania, Rhode Island, and Washington impose collection or reporting requirements on referrers and marketplace facilitators.

Alabama's approach...

- Promote voluntary collection by remote sellers through Simplified Sellers Use Tax Remittance Program (“SSUT”).
- Authorize DOR to require reporting of retail sales and customer notifications by non-collecting sellers.
- Open SSUT to marketplace facilitators to remit simplified tax on sales made by or on behalf of marketplace sellers or, alternatively, to comply with notice and reporting requirements.

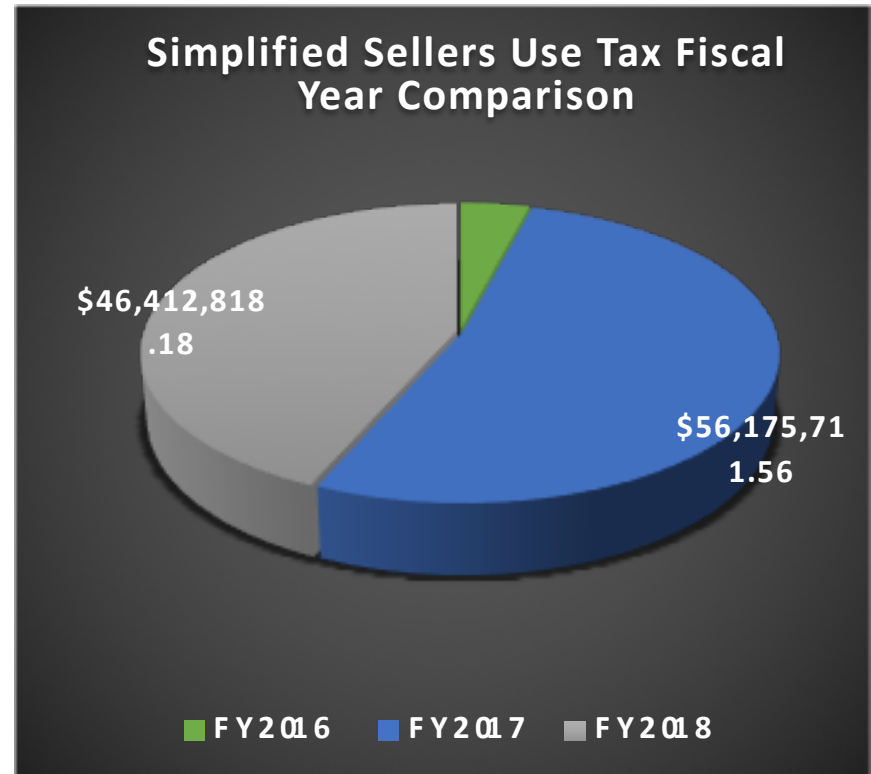
Simplified Sellers Use Tax Remittance Program

- Effective October 1, 2015 – Participation voluntary for eligible sellers
- Eligible seller collects, reports, and remits a flat 8 percent tax in lieu of combined state and local sales or use taxes otherwise due
 - Regardless of where shipped in Alabama
 - No additional sales or use tax due on the transaction (including prior periods)
- Collected on all sales, unless purchaser has certificate of exemption, sales tax license, or direct pay permit
- Two percent collection discount for participants (effective January 1, 2019, capped at \$8,000 per monthly reporting period)
- Single return filed electronically, single audit
- Guaranty of continued participation in the program even if federal legislation allows state's to require collection by remote sellers

SSUT Program repositioned Alabama from being one of the most difficult states for remote tax collection to one of the easiest.

Simplified Sellers Use Tax Remittance Program

- Currently 194 active remote sellers participating in the program
- 341 applicants to date - 214 approved/ 127 denied
- Total revenue collected through the program to date (3rd quarter FY18 - April): \$106,953,770
- FY2018 Collections \$46.4 million through April (60% increase over same period FY 2017)



[HTTPS://REVENUE.ALABAMA.GOV/SALES-USE/SIMPLIFIED-SELLERS-USE-TAX-SSUT/](https://revenue.alabama.gov/sales-use/simplified-sellers-use-tax-ssut/)

Alabama to implement reporting and notice requirements with the alternative option for simplified collections and remittance for sellers and marketplace facilitators...

Ala. Code 1975, § 40-2-11(7)(b)

- Authorizes DOR to require non-collecting sellers to report retail sales and provide customer notifications and to impose penalties for non-compliance.

Ala. Act No. 2018-539 – Effective January 1, 2019

- Marketplace facilitators must either collect and remit SSUT on Alabama sales made by or on behalf of third party, marketplace sellers or –
- Comply with reporting and customer notification requirements to be promulgated pursuant to section 40-2-11(7)(b).

Marketplace Facilitators and Sellers

- “Marketplace Facilitator” is broadly defined in the Act as a person that directly or indirectly facilitates a sale between a purchaser and a marketplace seller through its physical or electronic marketplace and engages in other activities with respect to the seller’s products, including but not limited to order taking, payment processing, fulfillment services, returns and exchanges, setting prices, and branding the seller’s products as its own.
- *Qualifying amount:* Requirement to remit or report applies to marketplace facilitators with Alabama retail sales of greater than \$250,000 annually or an amount otherwise prescribed by the DOR.
- “Marketplace Seller” is defined as a seller that is not a related party to a marketplace facilitator and that makes sales through any physical or electronic marketplaces operated by a marketplace facilitator.

Benefits of collecting through SSUT...

- Marketplace Facilitators that elect to collect and remit SSUT (and their marketplace sellers) receive the benefits/protections available to other SSUT participants.
 - Flat 8%, single tax (collected for all marketplace sellers, even those with Alabama nexus) in lieu of combined state and varying local tax rates
 - Collected on all sales, unless purchaser has certificate of exemption, sales tax license, or direct pay permit
 - Single return filed electronically, single audit
 - Amnesty for marketplace facilitators *and* its marketplace sellers
 - Guaranty for the marketplace facilitator *and* its marketplace sellers of continued participation in the SSUT program, even if Congress acts to allow states to require remote sellers to collect and remit sales taxes
- Plus, prohibition on class actions against marketplace facilitators for overpayments of SSUT

Alabama is drafting rules for non-collecting sellers and marketplace facilitators for submission and will be taking public comments later this summer (2018).

- Non-exclusive examples of reporting/notice requirements in states imposing requirements on marketplace facilitators
 - Conspicuous notices on the marketplace forum that state sales/use tax may be due and that state requires purchaser to file a return if use tax is due
 - Similar transactional notices to purchasers of marketplace sellers products
 - Annual purchase statements to purchasers, along with notice that the facilitator is required to submit an annual report to the DOR of these purchases
 - Annual report to the DOR to include each purchasers name, address, and aggregate purchases, and the name and address of each marketplace facilitator or marketplace seller that made the sales to the purchaser
- Penalties in states imposing reporting requirements on facilitators fairly substantial

Potential challenges/roadblocks to state information reporting requirements...

- Congressional Action:

“As to the state regulation at issue in this case, up to now Congress has been silent—it has not preempted or consented to the Colorado Law. The question then is whether the Constitution's affirmative grant of the commerce power to Congress should be interpreted to circumscribe the Colorado Law. The judiciary's answer to this question need not be final. If we uphold the law, Congress can pass its own law and preempt the Colorado Law. “

Direct Mktg Ass'n v. Brohl, 814 F.3d 1129, 1135-36 (10th Cir. 2016).

- A different outcome on the commerce clause analysis in another circuit
- Privacy issues

“Physical presence” as a broad concept

- Exists where in-state representatives act for a vendor to “establish and maintain a market”
 - The representatives need not be sales representatives or even commercial actors
- Exists where the vendor owns or leases in-state real or tangible property
 - The property does not necessarily have to be property that enhances in-state sales

Broad physical presence rulings

- *Dell Catalog Sales L.P. v. Taxation & Revenue Dep't.*, 199 P.3d 863 (N.M. 2008) (nexus created by activities of unrelated service provider that provides warranty work, which serves to “establish and maintain” vendor’s in-state market)
- *Overstock.com, LLC v. NY Dep’t of Tax & Finance*, 20 N.Y.3d 586 (2013) (nexus created by unrelated parties that agree to place links on their websites that, when clicked, direct users to a vendor’s website; the parties are compensated by commissions determined based on clicks and subsequent online purchases)

Broad physical presence rulings

- *Scholastic Books Clubs, Inc. v. Farr*, 373 S.W.3d 558 (Tenn. 2012) (nexus created by school teachers that facilitate in-state sales on behalf of out-of-state bookseller)
- *Travelscape v. South Carolina Dep't of Revenue*, 391 S.C. 89 (S.C. 2011) (nexus created by services provided by unrelated in-state hotel workers); *City of Charleston v. Hotels.com*, 586 F.Supp. 2d 538 (2008) (nexus created by in-state hotels owned and operated by unrelated parties)

Quill; software & physical presence

- *Quill*, 504 U.S. at 315 n.8:
- “[T]itle to a few floppy diskettes present in a State might constitute some minimal nexus”
- But “the existence in [a state] of **a few** floppy diskettes to which [the vendor] holds title” does not result in nexus because it would represent a mere de minimis or “slightest presence.”

Quill; software & physical presence

- Software in *Quill* was a program included on floppy diskettes that enhanced the sale of Quill products
- Quill's Supreme Court brief: during the tax period in question "Quill sold or gave [a diskette] to six customers in North Dakota only one of whom ever used it to order merchandise from Quill"

Software as tangible personal property

- Software is generally considered to be tangible personal property under that term's common law definition and under the sales tax law of most states
- The Streamlined Sales and Use Tax Agreement, which has been adopted by 24 states, defines tangible personal property to include prewritten computer software, however transferred

Software as tangible personal property

- “When stored on magnetic tape, disc, or computer chip, this software, or set of instructions, is physically manifested in machine readable form by arranging electrons, by use of an electric current, to create either a magnetized or unmagnetized space.” South Cent. Bell Tel. Co. v. Barthelemy, 643 So. 1240, 1246 (La. 1994).
- Software “is not merely knowledge, but rather is knowledge recorded on physical form which has physical existence, takes up space on the tape, disc, or hard drive, makes physical things happen and can be perceived by the senses.” *Id.*

MA regulation, 830 CMR 64H.1.7

- Physical presence is created by:
- “property interests in and/or the use of in-state software (e.g., "apps") and ancillary data (e.g., "cookies") which are distributed to or stored on the computers or other physical communications devices of a vendor's in-state customers, and may enable the vendor's use of such physical devices”
- Legal analysis explained by DOR Directive 17-1 (later revoked by DOR Directive 17-2)

MA regulation, 830 CMR 64H.1.7

- Physical presence is also created by
- “contracts and/or other relationships with content distribution networks resulting in the use of in-state servers and other computer hardware and/or the receipt of server or hardware-related in-state services”

MA regulation, 830 CMR 64H.1.7

- Physical presence is also created by
- “contracts and/or other relationships with online marketplace facilitators and/or delivery companies resulting in in-state services including, but not limited to, payment processing and order fulfillment, order management, return processing or otherwise assisting with returns and exchanges, the preparation of sales reports or other analytics and consumer access to customer service.”

South Dakota *Wayfair* reply brief

- “This Court has never expanded on *Quill* or interpreted the contours of ‘physical’ presence. It can thus interpret that standard as broad enough to encompass the inescapable presence of internet retailers ‘via cell phones, tablets, and laptops’ that it had no opportunity to consider in 1992—largely limiting *Quill* to its mail-order holding.”

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MA regulation, 830 CMR 64H.1.7

- Asserts jurisdiction when remote vendor has the contacts referenced and also has “in excess of \$500,000 in Massachusetts sales from transactions completed over the Internet *and* made sales resulting in a delivery into Massachusetts in 100 or more transactions.”
- Similar to SD approach and that being used in other states

Software nexus

- Ohio, H.B. 49, enacted July 30, 2017
- Rhode Island, H.B. 5175, enacted Aug. 3, 2017
- Iowa, Senate File (SF) 2417, enacted May, 2018
- Kansas, H.B. 2756 (introduced, not adopted)
- *See Newegg, Inc. v. Testa*, 149 Ohio St.3d 289 (2016) (court concludes that “physical presence” nexus standard does not apply to Ohio’s CAT tax; this “makes unnecessary consideration of whether Newegg's Internet contacts with its Ohio customers constituted a physical presence for Commerce Clause purposes”).

Current MA litigation

- *Crutchfield Corp. v. Harding*, No. CL17001145-00 (Va. Cir. Ct. Feb. 15, 2018)
- Argument that application of 830 CMR 64H.1.7 to the litigant in question violates *Quill* and the Internet Tax Freedom Act
- Referenced in Petitions for Writ of Certiorari, *Franchise Tax Bd. v. Hyatt*, (March, 2018) and *Nevada Dept. of Wildlife v. Smith*, (April, 2018) (question whether *Nevada v. Hall*, 440 U.S. 410 (1979), which permits a sovereign State to be sued in another State's courts without its consent, should be overruled)