

FEBRUARY 2020



Online Sales Tax Avoidance After *South Dakota v. Wayfair*

Like other professionals in the distribution industry, NAHAD members operate on tight margins. In many cases, online retailers undercut NAHAD members' prices by not paying sales tax on remote transactions; in some cases, online retailers use the lack of sales tax as a way to advertise to customers. Business models based on sales tax avoidance distort the market and place main street businesses at an unfair disadvantage, but luckily the Supreme Court has intervened on the side of states wanting to collect sales taxes.

In *South Dakota v. Wayfair*, the Supreme Court gave states the ability to collect sales taxes from online retailers selling products into the state. Shortly before and quickly after the case was decided, states began passing laws to collect sales taxes on remote transactions, and already 43 states require sales taxes on remote transactions. These states have implemented safe harbor provisions to protect small sellers so it is important for NAHAD members to know if they meet the requirements to collect sales taxes on remote transactions on non-exempt goods.

Background

The issue of online sales taxes nearly pre-dates the internet itself, in 1992 the U.S. Supreme court ruled that a company needed to have "substantial nexus" within a state in order for the state to collect sales tax. In the case of *Quill Corp. v. North Dakota*, a catalog seller with no physical presence in North Dakota refused the state's efforts to collect sales tax on transactions to customers within North Dakota. The court ruled in favor of the Quill Corporation and determined that significant nexus was required by the dormant commerce clause, but also asked Congress to resolve the issue. "The underlying issue here is one that Congress may be better qualified to resolve and one that it has the ultimate power to resolve."

With the rise of e-commerce many states were unable to require the collection and remittance of sales tax for items purchased in the state from out of state sellers. Many states implemented use taxes where residents were required to report their total online purchases and calculate the sales tax, however compliance was very low. In response to the growing concern from lawmakers fearing lost revenue, and brick and mortar stores losing business to online competitors, Congress began to look at ways to fix the issue. In 2013, the U.S. Senate passed

the Marketplace Fairness Act which would grant the states authority to tax online sales; however, the legislation was blocked by Judiciary Chairman Bob Goodlatte (R-VA-6).

South Dakota v. Wayfair

With legislation blocked for several years by Chairman Goodlatte and anti-tax conservatives, states began to look for a judicial solution to the problem. South Dakota passed legislation requiring any business with an “economic nexus” to remit sales tax to the state even if the business had no physical presence in the state. Wayfair, an online retailer of home goods, sued the state on the basis the law violated the precedent set by Quill. In 2017 the lawsuit lost at the state level and the decision was upheld by the South Dakota Supreme Court. South Dakota appealed the decision to the U.S. Supreme Court.

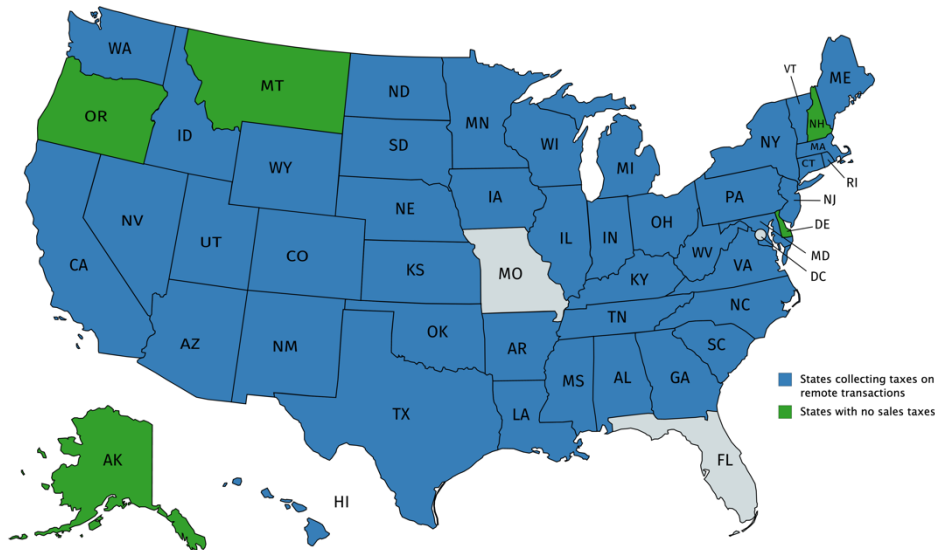
In parallel to the court case, Congresswoman Kristi Noem (R-SD-AL) introduced the Remote Transactions Parity Act to head off fears of the court re-affirming Quill. The bill would have set up a streamlined system for collecting sales and use taxes for businesses meeting the minimum sales figures:

1. has gross annual receipts exceeding specified amounts, which are phased in from \$10 million for the first year following the effective date, to \$5 million for the second year, and \$1 million for the third year; or
2. utilizes an electronic marketplace for the purpose of making products or services available for sale to the public.

The bill was not able to pass prior to the court decision and the two bill champions, Rep. Kristi Noem and Rep. Jason Chaffetz, are no longer in Congress. Ultimately, on June 21, 2018 the U.S. Supreme Court overturned the Quill decision and allowed states to require online vendors to collect state sales taxes. The Supreme Court in its decision limited the ways states could create laws to collect taxes by endorsing the methods used by South Dakota and specifically mentioning retroactive collections would not be viewed favorably.

Post Wayfair Actions by States

Since the decision, 43 states and the District of Columbia have begun to collect sales taxes on remote sellers. Five states have no sales tax, and two states have not enacted legislation or regulations to allow for the collection. States have been following the South Dakota model to ensure they are not overturned. South Dakota's law only applies to sellers that, on an annual basis, deliver more than \$100,000 of goods and services into the state or engage in 200 or more



transactions for delivery of goods and services into the state.

In his dissenting opinion, Chief Justice Roberts, “Nothing in today’s decision precludes Congress from continuing to seek a legislative solution,” however Rep. Jerry Nadler (D-NY-19), the House Judiciary Committee Chairman, has said that he does not plan to use legislation to intervene after the Supreme Court’s decision.

Complying With State Online Sales Tax Laws

For any distributors working in a single state, the rules for collecting sales taxes on online sales have not changed as states were always able to require a business with a physical location in the state to collect and remit sales taxes, even on online transactions. However, distributors that sell into multiple states without a physical location in those states will need to ensure they are complying with each state’s tax laws.

One of the most important definitions to know is whether a state taxes business-to-business, wholesale, or for-resale transactions. If the destination state does not tax items sold to another business for resale then no sales tax collection is necessary, but it is important to document that the transaction is exempt, often through the use of exemption certificates. However, it is

also important to know the class of goods being sold to these customers. Some products, such as tools used by contractor customers, must have sales tax collected.

In dealing with 43 states and DC and over 10,000 taxing jurisdictions in the US, there is a potential of a lot of complexity in trying to comply with the various laws. Luckily the South Dakota law was designed to be easily replicable and states are banding together to improve compliance. A total of 23 states have joined the Streamlined Sales Tax Project to further simplify the process of remote sales tax collections. These streamlined states use a uniform tax base, single point of administration, and have limited ability to use local sales tax rates. Additionally, these states share a single software application for businesses to integrate into their systems for easy sales tax collections.

The Supreme Court, as the judicial branch of government, cannot require states to develop software to make it easier for businesses to comply with the various state requirements, however the court did say the onus is on the state to have a minimum compliance burden. To achieve this, states outside the SSTP have developed free applications that work with major business software systems to track the delivery location of the product and its tax rate.

In addition to software, many states have included a safe harbor provision to prevent small businesses from being harmed by the new laws. Nearly every state has created a safe harbor for small sellers to be exempted from collecting sales tax on remote transactions, and only Kansas has not included a safe harbor in its law and will likely implement one before a lawsuit is filed. Each safe harbor represents the amount or number of transactions into an individual state, not the total sales/transactions of the company. These safe harbors fall into three categories, gross sales, gross sales or transactions, and gross sales and transactions. Some states, even if they exempt resale transactions, will count all transactions toward the safe harbor, each state's software will be designed to count the transaction based on the state's requirements.

State	Safe Harbor	State	Safe Harbor	State	Safe Harbor
Alabama	Gross Sales: \$250,000	Louisiana	Gross Sales: \$100,000 OR Transactions: 200	Ohio	Gross Sales: \$100,000 OR Transactions: 200
Alaska	No sales tax	Maine	Gross Sales: \$100,000 OR Transactions: 200	Oklahoma	Gross Sales: \$100,000
Arizona	Gross Sales: \$200,000	Maryland	Gross Sales: \$100,000 OR Transactions: 200	Oregon	No sales tax
Arkansas	Gross Sales: \$100,000 OR Transactions: 200	Massachusetts	Gross Sales: \$100,000	Pennsylvania	Gross Sales: \$100,000
California	Gross Sales: \$500,000	Michigan	Gross Sales: \$100,000 OR Transactions: 200	Rhode Island	Gross Sales: \$100,000 OR Transactions: 200
Colorado	Gross Sales: \$100,000	Minnesota	Gross Sales: \$100,000 OR Transactions: 200	South Carolina	Gross Sales: \$100,000

Connecticut	Gross Sales: \$100,000 AND Transactions: 200	Mississippi	Gross Sales: \$250,000	South Dakota	Gross Sales: \$100,000 OR Transactions: 200
Delaware	No sales tax	Missouri	No remote transactions tax	Tennessee	Gross Sales: \$500,000
Florida	No remote transactions tax	Montana	No sales tax	Texas	Gross Sales: \$500,000
Georgia	Gross Sales: \$100,000 OR Transactions: 200	Nebraska	Gross Sales: \$100,000 OR Transactions: 200	Utah	Gross Sales: \$100,000 OR Transactions: 200
Hawaii	Gross Sales: \$100,000 OR Transactions: 200	Nevada	Gross Sales: \$100,000 OR Transactions: 200	Vermont	Gross Sales: \$100,000 OR Transactions: 200
Idaho	Gross Sales: \$100,000	New Hampshire	No sales tax	Virginia	Gross Sales: \$100,000 OR Transactions: 200
Illinois	Gross Sales: \$100,000 OR Transactions: 200	New Jersey	Gross Sales: \$100,000 OR Transactions: 200	Washington	Gross Sales: \$100,000
Indiana	Gross Sales: \$100,000 OR Transactions: 200	New Mexico	Gross Sales: \$100,000	West Virginia	Gross Sales: \$100,000 OR Transactions: 200
Iowa	Gross Sales: \$100,000	New York	Gross Sales: \$500,000 AND Transactions: 100	Wisconsin	Gross Sales: \$100,000 OR Transactions: 200
Kansas	No safe harbor	North Carolina	Gross Sales: \$100,000 OR Transactions: 200	Wyoming	Gross Sales: \$100,000 OR Transactions: 200
Kentucky	Gross Sales: \$100,000 OR Transactions: 200	North Dakota	Gross Sales: \$100,000	District of Columbia	Gross Sales: \$100,000 OR Transactions: 200

Even though the court pushed for minimal compliance efforts in its decision, there is still a lot of compliance a business must be aware of. For distributors without a previous physical nexus, resale transaction exemptions and software to track transactions for the safe harbor provisions will make it easier to comply.