



# **Collecting Sales and Use Taxes from Out-of-State Sellers**



# Quill Corp. v. North Dakota

504 U.S. 298 (1992)

# Quill Corp. v. North Dakota

## ► Facts

### ○ North Dakota

- In 1987, North Dakota amended its sales and use tax law to require out-of-state sellers that did not have either an outlet or sales representative in the state to collect and remit sales and use tax on goods purchased for use within the state, if the retailer engaged in regular or systematic solicitation in the state

### ○ Quill

- Was a Delaware corporation with offices and warehouses in Illinois, California, and Georgia
- Did not have any employees work or reside in North Dakota and did not own any significant tangible property in North Dakota
- Sold office equipment and supplies through the use of catalogs, flyers, advertisements in national periodicals, and telephone calls
- Had annual national sales of over \$200 million
- Had about \$1 million in sales to 3,000 customers in North Dakota
- Was the sixth (6<sup>th</sup>) largest vendor of office supplies in North Dakota



# Relevant Constitutional Question

- ▶ Did North Dakota's sales and use tax law violate the Commerce Clause of the U.S. Constitution?

# The Commerce Clause

- ▶ Article I, § 8, cl.3 of the U.S. Constitution
  - Expressly authorizes Congress to regulate commerce with foreign nations, and among the several states
  - Prohibits certain state actions that interfere with interstate commerce – *South Carolina State Highway Dept. v. Barnwell Brothers, Inc.*, 303 U.S. 177 (1938).
- ▶ *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967)
  - U.S. Supreme Court outlined the physical presence requirement under the Commerce Clause when a state requires an entity to collect and remit sales and use tax
  - The U.S. Supreme Court decided that a state could not require an entity to collect and remit sales and use tax if the entity did not have a physical presence in the state
  - Physical presence generally means that the business has a location, employee, agent, warehouse, leased equipment, inventory or other aspect of its business physically present in the state
  - The physical presence requirement was not satisfied if the entity's only contacts with the state were by using the United States mail, or common carrier

# Quill - Supreme Court Decision

- ▶ North Dakota's law violated the U.S. Constitution's Commerce Clause
  - An entity must have a physical presence in the state for the state to impose a requirement on the entity to collect and remit sales and use tax
  - A mail-order business that does not have a physical presence in the state, other than by mail or common carrier does not meet the physical presence requirement
  - "Whether or not a State may compel a vendor to collect a sales or use tax may turn on [whether the vendor has a physical] presence in the taxing State [by way of] a small sales force, plant, or office"
- ▶ Role of Congress:
  - "[T]he underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve . . . Congress remains free to disagree with our conclusions"
- ▶ Consequence for state tax laws
  - Business are generally not required to collect and remit sales and use tax if the business does not have a physical presence in the state
  - "Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes"

# Development of the Internet

- ▶ 1991 – The world wide web becomes publically available \*
- ▶ 1993 – American Online (AOL) introduces email addresses, a Windows version of the platform and access to the world wide web †
- ▶ 1995
  - Amazon.com goes online ‡
  - AuctionWeb (eBay) goes online ^
- ▶ 1998 – Google's first web search page is released #

\* Source: <https://thenextweb.com/insider/2011/08/06/20-years-ago-today-the-world-wide-web-opened-to-the-public/>

† Source: <http://time.com/3857628/aol-1985-history/>

‡ Source: Byers, Ann (2006), Jeff Bezos: the founder of Amazon.com, The Rosen Publishing Group, pp. 46–47

^ Source: Cohen, Adam (2003), The Perfect Store, Boston: Back Bay Books.

#Source: <http://www.businessinsider.com/heres-what-google-looked-like-the-first-day-it-launched-in-1998-2013-9>

# Rise of e-Commerce Sales

- ▶ Online sales will account for 17% of all US retail sales by 2020 \*
- ▶ US online sales grew 13% year over year in 2017, five times faster than offline sales growth \*
- ▶ In 2000, US e-commerce sales were \$27.6 billion, by 2015 e-commerce sales were \$343 billion †

\* Source: <http://www.businessinsider.com/e-commerce-retail-sales-2022-amazon-2017-8>

† Source: <https://www2.deloitte.com/insights/us/en/economy/behind-the-numbers/holiday-ecommerce-sales-growth-forecast.html>



# Solutions

- ▶ E-commerce sales are subject to a state's sales and use tax laws if the retailer has a physical presence in the state
- ▶ Some out-of-state sellers voluntarily collect and remit sales and use tax
  - Streamlined Sales and Use Tax Agreement (SSUTA) – Arkansas is a member and collected approximately \$15.8 million in sales and use tax from volunteer out-of-state sellers in 2016 from a total of 3,200 registered retailers\*
- ▶ U.S. Congress
  - Remote Transactions Parity Act (first introduced in the House in 2015) & Marketplace Fairness Act (first introduced in the Senate in 2011)
    - Member states under the SSUTA are authorized to require sellers—other than those covered by a small seller's exception—to collect and remit sales and use tax on remote sales sourced to that state
    - Provides states that are not members to the SSUTA with the ability to also require sellers to collect and remit sales and use tax, if certain requirements are met, e.g. annual sales of more than \$500,000
    - Neither bill has been enacted

\* Source: Arkansas Department of Finance and Administration (note: tax amounts do not establish the method of sales activity by the companies)

# Colorado Solution

- ▶ In 2010, Colorado enacted a notification law requiring retailers without a physical presence in Colorado to:
  - Send a transactional notice to Colorado purchasers informing them that their purchase may be subject to Colorado sales and use tax
  - Send Colorado residents who purchase more than \$500 in taxable goods from the retailer an annual purchase summary with the following information:
    - Amounts of purchases
    - Categories of purchases
    - Dates of purchases
    - A reminder of the Colorado resident's obligation to pay Colorado sales and use tax on those purchases
  - Send the Colorado Department of Revenue an annual customer information report listing the names, addresses and total purchases of their Colorado customers
- ▶ The Colorado notice requirement does not apply to out-of-state retailers whose total gross sales in Colorado during the previous calendar year were less than \$100,000, provided the expected gross sales for the current calendar year are also less than \$100,000

# Colorado Solution - Litigation

- ▶ In 2010, the Direct Marketing Association (DMA) challenged Colorado's notification law alleging that the notice requirement violated the Commerce Clause under *Bellas Hess* and *Quill*
  - In 2012, the U.S. District Court for the District of Colorado granted summary judgment to the DMA and permanently enjoined enforcement of Colorado's notification law
  - In 2013, the U.S. Court of Appeals for the Tenth Circuit reversed the District Court deciding that the District Court lacked jurisdiction due to the federal Tax Injunction Act
- ▶ In 2015, U.S. Supreme Court decided that Colorado's notification law did not mandate an assessment, levy or collection of tax within the scope of the Tax Injunction Act and remanded the case back to the U.S. Court of Appeals for the Tenth Circuit to consider the constitutional issues
  - Justice Kennedy of the U.S. Supreme Court made statements in his concurrence questioning whether *Quill* needed by be reconsidered and potentially overturned

“Given [the rapid and extensive] changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier.”

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



# Colorado Solution - Litigation



- ▶ In 2016, the U.S. Court of Appeals for the Tenth Circuit decided that the Colorado notification law was constitutional and did not violate the Commerce Clause, since the law did not compel an entity outside of the state to collect and remit sales and use tax, but rather only provide notification to the Colorado buyer of his or her tax obligations under Colorado Law
- ▶ The DMA petitioned the U.S. Supreme Court to review the United States Court of Appeals second decision
- ▶ In December 2017, the U.S. Supreme Court denied DMA's petition
- ▶ As of July 2017, Colorado has been using and enforcing its notification law after the U.S. Court of Appeals for the Tenth Circuit upheld Colorado's notification law



# HB1388 of 2017: Colorado Approach

## Differences :

- ▶ Allows sellers to notify purchasers using electronic means
  - Eases burden on sellers
- ▶ Requires that the report to DFA include the delivery/shipping addresses provided by each purchaser
  - Clarifies information required to be provided by sellers
- ▶ Clarifies that sellers that voluntarily collect and remit sales and use taxes do not have to comply with the notification provisions
- ▶ Applies the same requirements to facilitators (those who assist sellers in making sales)



# South Dakota Solution

- ▶ In 2016, South Dakota enacted a law that requires out-of-state sellers with no physical presence in the state to collect and remit sales and use tax and follow the same tax laws as sellers with a physical presence in the state, if the seller meets one of the following criteria
  - The seller's gross revenue of sales and services in the state exceeds \$100,000 or
  - The seller has 200 or more separate transactions in the state
- ▶ It was South Dakota's goal to directly challenge the *Quill* decision in accordance with Justice Kennedy's suggestion in the Colorado case



# South Dakota Solution - Litigation

- ▶ In April 2016, South Dakota sued Wayfair, Overstock.com and Newegg.com to enforce South Dakota's law requiring out-of-state sellers without a physical presence in the state to collect and remit sales and use tax
- ▶ In September 2017, the South Dakota Supreme Court ruled that South Dakota's law violated the Commerce Clause based upon *Bellas Hess* and *Quill*
- ▶ On January 12, 2018, the U.S. Supreme Court granted South Dakota's petition to hear the case, *State of South Dakota v. Wayfair Inc.*

# SB 140: South Dakota Approach

## Differences:

- ▶ Repeals statute on affiliated persons
  - Removes potential conflict in AR law
- ▶ Provides an alternative to collection (notification to purchasers and report to DFA)
  - Potentially less burdensome provision that has been upheld
- ▶ Clarifies that an administrative injunction does not enjoin an existing lawsuit to establish the validity of the collection or reporting/notification requirement
- ▶ Clarifies that the statute does not affect the obligation of a seller who collects a tax on a transaction in the state to remit the taxes to the state
- ▶ Requires the Arkansas Tax Reform and Relief Task Force to review the amount of revenue attributed to this statute and make recommendations on the use of those revenues





# South Dakota v. Wayfair

On appeal to the United States Supreme Court



# South Dakota v. Wayfair

- ▶ Sole point on appeal is the validity of South Dakota's "kill *Quill*" legislation under federal constitutional law
- ▶ South Dakota argues that a sufficient economic connection should be all that is required because the physical presence requirement:
  - Hurts state and local revenues
  - Provides an unfair advantage, or subsidy, to out-of-state businesses
  - Burdens interstate commerce by encouraging market inefficiency
  - Is not part of other case law on overcoming Commerce Clause issues in tax cases



# South Dakota v. Wayfair

- ▶ South Dakota also stated that special justifications exist for doing away with the *Quill* physical presence rule
  - Advances in payment processing
  - Simplified sales and use tax laws, which leads to lower compliance costs
  - Criticism from members of the U.S. Supreme Court and lower courts
  - “Physical presence” is not a clear standard
- ▶ In response to *Wayfair*, South Dakota noted that
  - Advances in technology have made multistate state collection easier and cheaper
  - Alternatives (such as the Colorado approach) are less efficient and impose a greater burden on interstate commerce
  - Congress has not responded to *Quill* with enacted legislation
- ▶ South Dakota requested that this case be heard without delay to avoid state and local governments losing more revenue and parties spending more money on litigating these issues

# South Dakota v. Wayfair

- ▶ Wayfair argued that the Supreme Court should not reexamine *Quill* because
  - The issue should be addressed by Congress
  - South Dakota did not properly develop a record for the Court to consider, which would leave it up to the Court to develop the facts
  - Remote sellers have relied on *Quill* for years
  - Courts continue to cite *Quill* favorably and have not questioned its application to state sales and use taxes
  - The “physical presence” standard is not difficult to apply (de minimis standard)
  - Multistate tax collection is still burdensome and expensive
  - Any problems related to the “physical presence” standard are self correcting
  - Remote sellers are at a disadvantage compared to local sellers
  - Doing so would raise issues of retroactive liability
  - There are other tools to increase use tax collection



# Some Potential Outcomes and Implications for the State

## ► **Overrule *Quill* entirely**

- Three of nine Supreme Court justices have indicated that *Quill* should be overruled
- Could incorporate South Dakota's focus on an economic connection or another standard
- May still leave some issues open for Congress to decide

## ► **Arkansas**

- Streamlined Sales Tax state like South Dakota so similar ease of taxation, if that is an issue
- Consider retroactivity issue
- SB140 could be simplified to remove provisions aimed at streamlining the kill-*Quill* litigation

## ► **Overrule *Quill* in part**

- Possibly limit *Quill* to non-internet-only sales

## ► **Arkansas**

- SB140 legislation for online sales and HB1388 for non-internet sales



# Some Potential Outcomes and Implications for the State

## ► Reaffirm *Quill*

- Similar arguments were made in *Quill* regarding advances in economy and technology
- Reliance of businesses and interest in stability demands adherence to prior case law
- Congress has been more active in seeking to address this issue
- Problem is self correcting

## ► Arkansas

- Could still proceed with HB1388-type legislation

## ► Decline to decide the *Quill* question

- Unlikely, but not impossible if the Court decides this case is not the right one

## ► Arkansas

- Could proceed with HB1388-type legislation while pursuing litigation under a bill similar to SB140

A decorative graphic on the left side of the slide. It features a solid dark blue vertical bar on the far left. From the right edge of this bar, several thin, curved lines in shades of blue and light blue sweep upwards and to the right. A prominent, solid blue arrow points horizontally to the right, overlapping the curved lines.

**Questions?**