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U.S. STATES EXPAND EFFORTS TO COLLECT TAXES FROM OUT-OF-STATE BUSINESSES

Smarter Way to Cross Blog Archives
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Twenty-four years ago, the U.S. Supreme Court announced in *Quill v. North Dakota*, 504 U.S. 298 (1992), that in order for a U.S. state to require an out-of-state business to collect and remit sales and use taxes on its sales to in-state customers, the business must have a physical presence—such as a store, office, or employees—in the state. This ruling permitted "remote" businesses, such as those engaged in mail-order or on-line sales, to avoid sales tax collection and remittance requirements. Since then states have struggled mightily to pare back the Quill holding and stem the sales tax revenue lost to remote sales.

Two months ago, South Dakota lawmakers passed a law that sets dollar and transaction thresholds for determining whether remote, out-of-state retailers must collect taxes on sales to South Dakota customers. The law requires no physical presence in the state and therefore is a blatant violation of Quill. With the passage of the new law South Dakota is suddenly at the forefront of the national conversation on physical presence nexus and state taxation.

The South Dakota law, SB 106, provides that every out-of-state remote seller must collect sales tax if their annual sales into the state exceed $100,000 or if the remote seller conducts at least 200 separate transactions with South Dakota customers in a year, regardless of any physical presence in the state. This rule violates the physical presence test announced by the U.S. Supreme Court in *Quill* and greatly expands current sales tax nexus rules. Moreover, SB 106, which has 11 specific finding as to why *Quill* should be overturned, was clearly written with a court challenge in mind. South Dakota likely believes the timing is right for such a challenge. It was, after all, only in March of last year that U.S. Supreme Court Justice Anthony Kennedy seemed to invite a new challenge to *Quill*, announcing in a concurring opinion that "[i]t is unwise to delay any longer a reconsideration of the court's holding in *Quill*." And adding, "A case questionable even when decided, *Quill* now harms states to a degree far greater than could have been anticipated earlier." Admittedly, the views of one judge, even a Supreme Court Justice, are not enough to change existing law, but South Dakota is not alone in its pursuit to test the limits of taxing out-of-state retailers.

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Nearly half of the U.S. states now have "click-through" nexus, or "affiliate" nexus, laws (also known as "Amazon laws") on their books. These laws generally provide that a connection (or nexus) between the state and a remote retailer is created through a seller's ties to in-state affiliates that link their websites to the online retailer. Accordingly, these remote affiliated retailers are required to collect sales and use taxes in states with Amazon laws. And earlier this month, the Supreme Court of Ohio heard oral argument in a case involving the Ohio Commercial Activity Tax ("CAT")—which provides that taxpayers have nexus with Ohio and are subject to the CAT if they have at least $500,000 of annual sales to Ohio. The CAT is not a pure sales and use tax. Specifically, the tax is not imposed on the purchaser at the time of a sales transaction, but instead is based on the seller's gross receipts. Ohio, therefore, argues that the CAT is not subject to Quill's physical presence standard and that its "bright line" nexus threshold is constitutional. Moreover, several other states, including New York (http://www.hodgsonruss.com/newsroom-publications-new-york-nexus-widens.html), have adopted economic nexus standards that subject out-of-state corporations to state-level corporate income and franchise taxes based solely on in-state receipts (New York now imposes a corporate franchise tax filing obligation on out-of-state corporations that derive more than $1 million in receipts from New York State, whether or not the corporation has a physical presence in the state).

Proponents of these expanded nexus laws, especially in the context of sales and use taxes, argue that local brick and mortar stores are harmed by existing laws that artificially distinguish between retailers with physical stores inside a state's borders and those outside of the state. According to supporters, the modern, digital economy means that retailers can be present everywhere and there's no reason that large, digital retailers shouldn't have to comply with the same rules as local "Mom and Pop" vendors. Opponents, however, claim that states such as South Dakota are blatantly violating Supreme Court precedent and impermissibly imposing unconstitutional tax compliance requirements on out-of-state vendors. Online retailers also complain about the compliance costs of expanded tax nexus rules, noting the administrative headache of calculating and paying taxes in 50 different states.

Regardless of your personal views, however, online retailers, especially those with significant sales into a specific U.S. state, must now consider whether these sales trigger tax collection, reporting and/or payment requirements, regardless of the fact that the retailer may have no physical presence in the state.