



## “Baby Steps” Toward Full Sales Tax Enforcement (or Perhaps a Quill Challenge?)

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- Congress
  - MFA
- SCOTUS
  - New test case
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- 2015: EU updated general VAT rules applicable to digital sales
- Previously:
  - Only companies located outside EU had to collect
  - Businesses selling digital goods into Europe could charge customers the VAT of the country in which the firms were based

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- **Now:**
  - All digital companies—whether located within or outside the EU—that sell telecommunications, broadcasting and e-services to customers in EU countries must collect and report
  - VAT now based on the rate in the country where the customer resides
- **Always: broad-based tax**
  - no minimum sales threshold
  - virtually all goods and services that can be purchased and downloaded by retail consumers on the web fall within the scope of the VAT rules

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- In United States, digital goods = downloads of music, games, e-books.
- EU has a broader definition that includes digital or electronic services:
  - images or text, such as photos, screensavers, e-books and other digitized documents e.g. PDF files
  - music, films and games, including games of chance and gambling games, and of programs on demand
  - online magazines
  - website supply or web hosting services
  - distance maintenance of programs and equipment
  - supplies of software and software updates
  - advertising space on a website
- Expected to continue expanding

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### How VAT Works

Businesses collect the value-added tax (VAT) on their sales and pay it on their purchases from other businesses. This effectively turns them into tax-collecting agencies. The VAT moves up the production chain until consumers ultimately pay the entire cost of the VAT. Consumers are often unaware that a tax was levied at all because the VAT is often embedded in the price of goods. This is why the VAT is often referred to as a "hidden tax."

In this example, a 10 percent VAT is applied to the production and sale of a shirt.

STEP	DESCRIPTION	SALE PRICE	VAT COLLECTED BY SELLER	CREDIT FROM PREVIOUS STAGE	NET VAT COLLECTED
STEP 1	Farmer grows cotton and sells to textile maker for	\$1.00	\$0.10	-\$0.00	\$0.10
STEP 2	Textile maker makes fabric and sells to clothes maker for	\$5.00	\$0.50	-\$0.10	\$0.40
STEP 3	Clothes maker sews a shirt and sells to retailer for	\$10.00	\$1.00	-\$0.50	\$0.50
STEP 4	Clothing retailer prices shirt for	\$20.00	\$2.00	-\$1.00	\$1.00
					<b>TOTAL VAT COLLECTED = \$2.00</b>

**WHO PAYS?**  
When the customer buys the shirt, the \$2 value-added tax is added to the final sale price (\$22), effectively making the customer pay the full cost of the 10 percent VAT.

Source: The Heritage Foundation. Chart 1 - 8/2009 heritage.org  
Source: <http://www.bemoneywise.com/what-is-value-added-tax-vat/>

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**MTC** US vs. EU?



US sellers of digital goods into EU at a disadvantage vs. EU sellers of digital goods into US?

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**MTC** EU Enforcement?

~ €168 billion in VAT revenues lost due to noncompliance or non-collection in 2013—amounting to 15.2% of all VAT revenue.

- Companies w/branch offices in EU can be forced to comply
- Otherwise, turn to IRS for help?
- “black out” noncompliant sites?
- “web robot” to identify high-volume traders that aren’t registered for VAT?

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**MTC** US Options

- Congress
  - Efforts since early 2000s
  - Marketplace Fairness Act of 2013 has gone the farthest.
    - May 6th, 2013, the U.S. Senate passed MFA by a majority vote of 69 to 27. It went no further.
    - The MFA of 2015 (S. 698) was reintroduced in the Senate in March and referred to the Senate Committee on Finance, where it remains
- Unlikely to have progress in an election year

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**WTC**

- SCOTUS
  - Scalia: in *Wynne* dissent, objected to use of dormant commerce clause to strike down a state tax scheme:
    - lack of a governing principle in the field,
    - clause's instability, and
    - incompatibility of "synthetic commerce clause" cases with the judicial role.
  - Would he have similarly rejected the *Quill* reasoning?

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**WTC** SCOTUS

- *Quill*
  - Scalia, joined by Kennedy and Thomas, concurred in part and concurred w/judgment
    - I also agree that the Commerce Clause holding of *Bellas Hess* should not be overruled. Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis*. *Quill Corp. v. N. Dakota By & Through Heitkamp*, 504 U.S. 298, 320 (1992)
    - Referred to Congress for final say

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**WTC** Other Options

- Information collection subsequent to *DMA*?
  - May prove beneficial to state AND taxpayers

**THINK OUTSIDE THE BOX**

X	O	X
X	O	X
O	X	O

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 *DMA v. Huber (later DMA v. Brohl)*

- 2010 Colo. Rev. Stat. § 39-21-112(3.5), 1 Colo. Code Regs. § 201-1:39-21-112.3.5:
  - Imposed 3 obligations on remote sellers:
    - Send transactional notice to purchasers informing them they might owe use tax
    - Send CO purchasers who bought goods from the retailer totaling more than \$500 an annual purchase summary with dates, categories, and amounts, reminding them of use tax due
    - Send Department annual customer information report listing customers' names, addresses, and total amounts spent

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 *DMA v. Huber (later DMA v. Brohl)*

- Direct Marketing Association (DMA) filed facial challenge in district court, which granted summary judgment and permanent injunction
- 10<sup>th</sup> Circuit held district court lacked jurisdiction under Tax Injunction Act (TIA)
- DMA sued in state court and petitioned for cert to SCOTUS on issue of district court's jurisdiction

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 *DMA v. Huber (later DMA v. Brohl)*

- SCOTUS granted cert., found:
  - *Quill* established that a state "may not require retailers who lack a physical presence in the State to *collect* these taxes on behalf of the Department"
  - Colorado's notice and reporting requirements do not constitute a form of tax collection
    - notice and reporting requirements precede the steps of 'assessment' and 'collection'

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 *DMA v. Huber (later DMA v. Brohl)*

- SCOTUS ruling:
  - TIA did not apply because TIA determination precisely because the relief sought in this litigation-invalidating the Colorado Law-would not "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law"

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 *DMA, 10<sup>th</sup> Cir., Released 2/22/16*

- SCOTUS's holding cannot be squared with the district court's determination that the Colorado Law functionally compels the collection of taxes
- "we cannot identify any good reason to *sua sponte* extend the bright-line rule of *Quill* to the notice and reporting requirements of the Colorado Law"

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 *DMA, 10<sup>th</sup> Cir., Released 2/22/16*

- Gorsuch, J., [former clerk for Kennedy] concurring:
  - Indeed, if my colleagues are I are correct that states may impose notice and reporting burdens on mail order and internet retailers comparable to the sales and use tax collection obligations they impose on brick-and-mortar firms, **many (all?) states can be expected to follow Colorado's lead and enact statutes like the one now before us.**

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**WTC**

- Idea of *Quill* as an easing-out of *Bellas Hess*?
  - ...*Quill* might be said to have attached a sort of expiration date for mail order and internet vendors' reliance interests on *Bellas Hess*' rule by perpetuating its rule for the time being while also encouraging states over time to find ways of achieving comparable results through different means...*Quill*'s very reasoning—its *ratio decidendi*—seems deliberately designed to ensure that *Bellas Hess*'s precedential island would never expand but would, if anything, wash away with the tides of time.

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**WTC** Narrowing of *Quill*?



- Precludes *actual collection* of use tax
  - on mail orders only??

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**WTC** DMA, 10<sup>th</sup> Cir., Released 2/22/16

- DMA has 90 days from final judgment to appeal, likely will
  - May 23
- Will SCOTUS take another look? Will this be the *Quill* challenger?
  - Note even if SCOTUS grants cert, can skirt the *Quill* issue



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**MTC** Enforcement



- As things stand, remote seller may be required to:
  - Provide notice to purchasers
  - Provide annual purchase summary for customers who spend more than a threshold amount
  - Send Department annual customer information report listing customers' names, addresses, and total amounts spent
- How do you use the information?

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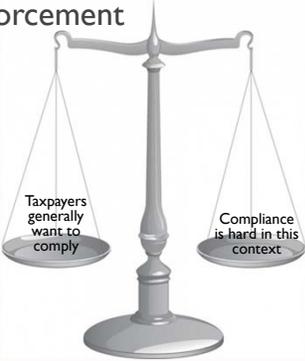
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**MTC** Enforcement




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**MTC** Enforcement Options

- States may:
  - (1) collect data from remote sellers on sales made to instate residents, broken down by taxable category;
  - (2) use data to determine the amounts owed by instate residents on remote purchases; and
  - (3)(a) inform residents of tax due OR
    - (b) provide their employers with the information allowing them to withhold the tax from wages paid at employee's option

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**MTC** Optional withholding

- Potential unpopularity in mandatory withholding



- Most effective/easiest collection generally at source of transaction or through 3d party
- Use tax always reported on individual income tax form

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**MTC** Optional withholding

- Employee may choose to have tax withheld based on percentage of income (like CA optional use pmts) or based on previous year's use tax
  - State will be able to adjust for actual amount based on seller's reports
  - Excess may be refunded/put toward income tax
- Employee may opt out and pay quarterly or yearly

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**MTC** Legal Issues in Withholding?

- No obvious legal constraint on the states
- No visible impediment to requiring an employer to withhold the tax from resident employee wages. (employer withholding already used for other purposes, such as collection of debts through garnishments)
- Potential obstacles:
  - First Amendment challenge
  - Possible challenge under "discriminatory tax" provision of the Internet Tax Freedom Act. (ITFA)

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 **First Amendment Challenge**

- Idea originally raised by DMA but not pursued
- *Amazon.com LLC v. Lay*, 758 F.Supp. 2d 1154 (W.D.Wash. 2010)
  - 2009: North Carolina DOR audited Amazon and requested "all information for all sales to customers with a North Carolina shipping address by month in an electronic format . . ."
  - Amazon provided DOR with detailed information about millions of purchases along with Amazon ID number, but no customer identifying information
  - First Amendment "protects a buyer from having the expressive content of her purchase of books, music, and audiovisual materials disclosed to the government" and NC could not show a compelling reason for request
- Not an issue here – need only broad categories

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 **ITFA Challenge**

- ITFA made permanent as part of the Trade Facilitation and Trade Enforcement Act of 2015 on Feb. 24, 2016
- Prohibits "multiple or discriminatory taxes on electronic commerce"
- May be considered discriminatory as including a collection obligation imposed on "a different person or entity than in the case of transactions involving similar goods accomplished through other means." (But could open to sales tax, as well).

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 **MTC model**

- <http://www.mtc.gov/Uniformity/Project-Teams/Model-SU-Notice-and-Reporting-Statute>

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 **First Steps**

- Digital goods
  - Definitions
  - Sourcing
- Currently
  - [http://www.mtc.gov/getattachment/Litigation/Litigation-Committee-Agenda-7-2015-\(1\)/Sourcing-Entertainment-in-a-Digital-World.pdf.aspx](http://www.mtc.gov/getattachment/Litigation/Litigation-Committee-Agenda-7-2015-(1)/Sourcing-Entertainment-in-a-Digital-World.pdf.aspx)

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 **Quill Litigation...**



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