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

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- Congress
  - MFA
- SCOTUS
  - New test case
- ??

- 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
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

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

How VAT Works

![VAT Calculation Diagram]

Source: http://www.bemoneyaware.com/what-is-value-added-tax-vat/
US vs. EU?

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

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?

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
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?

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

Other Options

- Information collection subsequent to DMA?
  - May prove beneficial to state AND taxpayers
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:
    1. Send transactional notice to purchasers informing them they might owe use tax
    2. 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
    3. Send Department annual customer information report listing customers’ names, addresses, and total amounts spent

DMA v. Huber (later DMA v. Brohl)

- Direct Marketing Association (DMA) filed facial challenge in district court, which granted summary judgment and permanent injunction
- 10th 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

DMA v. Huber (later DMA v. Brohl)

- SCOTUS granted cert., found:
  1. 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”
  2. 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’
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".

DMA, 10th 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."

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.
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.

Narrowing of Quill?

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

DMA, 10th 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
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?

Enforcement

Taxpayers generally want to comply
Compliance is hard in this context

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
Optional withholding

- Potential unpopularity in mandatory withholding
- Most effective/easiest collection generally at source of transaction or through third party
- Use tax always reported on individual income tax form

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)
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

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).

MTC model

First Steps

- Digital goods
  - Definitions
  - Sourcing
- Currently

Quill Litigation…