MEMORANDUM

To: Study Committee on Online Sales Tax Collection Obligations

From: Adam Thimmesch

Date: June 22, 2020

Re: Background Memo

This study committee has been formed to assess the need for, and feasibility of, state legislation regarding the collection of state sales taxes on online sales. The committee was formed largely in response to the experience of states and online vendors following the Supreme Court's 2018 decision in *South Dakota v. Wayfair*.[1] Until that case, states were prohibited from requiring sales-tax collection by vendors that did not have physical presences within their borders. The *Wayfair* Court overruled that limitation on state power.

Most states have already responded to *Wayfair* by passing statutes that require online vendors to collect their taxes. Those statutes are very similar, but some variations do exist. Most states have also passed statutes that require the collection of their sales taxes by "marketplace facilitators"— companies that facilitate the sales of goods by others. There is much wider variation among state laws of that type.

This memorandum provides background on these issues and proceeds in three parts. Part I provides background on *Wayfair* and the "online sales tax issue." Part II then discusses how states have responded to *Wayfair*. That section discusses (A) states' impositions of tax collection obligations on remote vendors, (B) states' impositions of tax-collection obligations on marketplace facilitators, and (C) two different uniformity efforts that have been undertaken on these issues by other groups involved in state tax policy. Part III concludes with a brief discussion of the potential for Congressional legislation on these issues.

I. Historical Context

State taxing authority is generally very broad, but it is limited by federal law in many ways. One source of restriction is the Supreme Court's so-called negative or dormant Commerce Clause. In 1967, the Supreme Court determined that the Commerce Clause of the U.S. Constitution prevented states from requiring the collection of their sales taxes by businesses that had not established certain physical connections within their borders.[2]

The Court upheld that rule in a 1992 decision—*Quill Corporation v. North Dakota*—that was best read as uneasy with the rule but hopeful that Congress would act to provide states with some relief.[3] Congress did not act, and the online economy grew through the 1990s and early 2000s.

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[1] 585 U.S. ___ (2018), 138 S. Ct. 2080.
[2] *National Bellas Hess v. United States*, 386 U.S. 753 (1967)
[3] *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

States worked on this issue on their own in a few different ways. Notwithstanding their efforts, though, states' revenue losses escalated with the emergence of online commerce, and their unrest with the physical presence rule continued to grow.

In 2016, South Dakota took matters into its own hands and directly challenged the old physical-presence rule by enacting a statute that required vendors to collect the state's tax without regard to their physical presences.[4] The law instead required vendors to collect the state's tax if the vendors made over $100,000 of sales to, or had engaged in 200 or more transactions with, South Dakota customers.[5]

A group of online retailers challenged the South Dakota statute, which led to the Supreme Court's *Wayfair* decision. The *Wayfair* Court determined that it would not strike down the South Dakota law and that it would, instead, overturn the physical-presence restriction on states. What the Court did not do, though, was to explicitly provide a rule for states to follow instead. The Court decided only that a state could require tax collection when a business "'avails itself of the substantial privilege of carrying on business' in [a] jurisdiction."[6] The Court offered little to no help regarding when that occurs other than to state that the taxpayers in the case had "clearly" met that standard based on their "economic and virtual contacts" with South Dakota.[7] The Court implicitly blessed the South Dakota statute, but provided little other guidance for states or retailers. States took the opportunity to expand their tax statutes in accordance with the South Dakota law.

II. The Status of State Laws post *Wayfair*

States have generally responded to the *Wayfair* decision in two ways. First, most states adopted statutes that closely mirrored the South Dakota law and required online vendors to collect their sales taxes based on their economic connections to the state. Most states also adopted statutes that required "marketplace facilitators" to collect and remit taxes on behalf of the vendors who used their platforms. Largely in response to the latter, both the National Conference of State Legislatures and the Multistate Tax Commission formed groups to study these statutes and to evaluate potential uniformity efforts. The following sections discuss those state statutes and the efforts undertaken by the NCSL and the MTC.

A. Remote Vendor Tax Collection post-*Wayfair*

In the wake of *Wayfair*, nearly every state with a sales tax has enacted some sort of "economic nexus" statute like the one at issue in *Wayfair*. Forty-five states impose general sales taxes, and 43 states and the District of Columbia require remote sales tax collection based on the South Dakota model.[8] The only two states with sales taxes that have not adopted such a law at the time of this memo are Missouri and Florida, and discussions in those states have been ongoing.

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[4] *See* S. 106, 2016 Leg., 91st Sess. (S.D. 2016).
[5] *Id.* § 1(1)–(2).
[6] *Id.* at 2099 (first alteration in original) (quoting Polar Tankers, Inc. v. City of Valdez, 557 U.S. 1, 11 (2009)).
[7] *Id.*
[8] National Conference of State Legislatures, *Remote Sales Tax Collection*, https://www.ncsl.org/research/fiscal-policy/e-fairness-legislation-overview.aspx (March 13, 2020).

States' "remote vendor" laws are generally very straightforward and similar to one another. The major variations between states' laws include: (1) whether they contain just a sales threshold (e.g., $100,000) or both a sales threshold and a transaction threshold (e.g., 200 or more transactions); (2) the precise levels of those thresholds; and (3) whether to include tax-exempt sales in the threshold calculations. Attached as Appendix A is a printout of a recent summary of these different state laws.

B. Marketplace Facilitators Laws post-*Wayfair*

A significant amount of commerce that is conducted online is not done directly between retailers and customers, but is facilitated by platforms that facilitate those exchanges. The most obvious examples are Amazon, eBay, and Etsy, but many different types of organizations offer similar platforms. The prevalence of this method of conducting online commerce has lead nearly every state with a sales tax to enact laws that require the collection of tax by "marketplace facilitators." Those laws operate in tandem with states' remote-vendor laws and serve a couple of different purposes for states.

First, requiring marketplace facilitators to collect and remit sales tax allows states to collect tax on the sales made by smaller retailers whose activity in the state fall below the state's remote-seller thresholds. Second, looking to those platforms to collect and remit tax provides states with administrative efficiencies by allowing state revenue authorities to focus their enforcement efforts on the marketplace facilitators rather than a multitude of smaller retailers. Those administrative efficiencies reduce the cost of tax administration to the state's taxpayers, but the practice does shift costs to the marketplace facilitators, their users, and the ultimate customers, depending on the characteristics of the market involved. Attached as Appendix B is a printout of a recent summary of these laws.

There is much wider variety in states' marketplace facilitator laws than in their remote vendor laws, and those are discussed in great detail in a white paper that is discussed in the next section of this memo. Among the biggest differences between state laws are (1) the definition of who constitutes a marketplace facilitator; (2) how responsibility for tax collection and record keeping is allocated between the marketplace provider and a retailer subject to a state's remote seller law; (3) which taxes the marketplace facilitators are required to collect for a state; (4) whether and to what extent marketplace facilitators and remote vendors can contractually allocate those responsibilities; and (5) how marketplace facilitators' "sales" are calculated.

C. Existing Uniformity Efforts and Issues

Wayfair allowed states to collect tax on significant amounts of transactions that had previously escaped the tax base due to consumers' large-scale failure to self-report tax on their online purchases. The NCSL reports that states' anticipated revenue gains ranged from $7 million to $190 million in 2019.[9] At the same time, retailers struggled with these new obligations and the variety of requirements imposed by states, especially with regard to states' laws regarding marketplace facilitators. The importance of this issue to states and to vendors led to two large

[9] National Conference of State Legislatures, *supra* note 8.

projects to address these issues. Those efforts—one by the National Conference on State Legislatures and one by the Multistate Tax Commissions—resulted in two important work products being released this year.

The first was the "Model Facilitator Sales Tax Collection Model Legislation" approved by the NCSL Executive Committee in January. That model is attached as Appendix C. The model imposes a collection obligation on remote vendors and on marketplace vendors and provides a multitude of definitions and procedures that govern those obligations. The major focus of that draft is clarifying when and how marketplace vendors are required to act.

The Multistate Tax Commission also formed a working group within its Uniformity Committee to address these issues. That group, the "*Wayfair* Implementation and Marketplace Facilitator Work Group", discussed these issues in great detail and received input and advice from a wide range of stakeholders. That working group issued a white paper in November of 2018 and then issued an updated paper in February 2020 to incorporate recent developments, including the NCSL model noted above. That whitepaper (the "MTC Whitepaper") is attached as Appendix D and contains a great deal of information on the differences between states' laws and the opinions of states and industry participants on these issues.

The MTC white paper, with appendices, is extensive and discusses a range of issues with which there is a lack of uniformity among states. I recommend that you read through that document to at least get a sense of the work that has been done on these issues. The first 9 pages provide an introduction and executive summary discussing the major issues that have been deliberated. These include:

1. <u>The breadth of a state's marketplace facilitator law</u>. One major line of demarcation between states' approaches is whether a facilitator needs to be involved in payment processing to be subject to the state's law or whether other forms of participation are sufficient.

2. <u>Who is the retailer?</u> Most states treat the marketplace facilitator as the "retailer" for purposes of tax collection responsibilities, rights, and obligations.

3. <u>What duties and liabilities are imposed on the marketplace facilitators?</u> Most states subject marketplace facilitators to record keeping requirements and impose liability on those parties for errors in the tax collection process. There are a range of practices on whether and to what extent a facilitator can be excused from liability for reliance on information provided by the retailer using its platform.

4. <u>What information exchanges between and among marketplace facilitators, sellers, and the state will be required?</u> There seems to be broad agreement that a model statute should impose clear information requirements on the parties to these commercial arrangements to help facilitate tax collection and remittance. There is also agreement that states should provide clear guidance to marketplace facilitators and retailers about what items are subject to tax in the state. There is less agreement about what information marketplace facilitators should have to provide to sellers, whether states should develop a certification process for facilitators, or whether

states should provide information to one another. States also vary in how they require sales to be reported by marketplace facilitators and vendors.

5. Should marketplace facilitators, sellers, and the state be able to modify the allocation of rights and responsibilities established under these laws? Some states' laws allow marketplace facilitators to negotiate between themselves on this matter. Other states allow the state revenue authorities to also provide exemptions to marketplace facilitators.

6. Should certain industries be excluded from these collection obligations? Some states require marketplace facilitators to collect tax on any taxable sale while others have limited their statutes to apply only to sales of tangible personal property. Some states also provide exemptions for particular industries.

7. Should marketplace facilitators have to collect all of a state's transaction taxes or just sales taxes? State laws in this area have generally only applied to state sales taxes, but states also impose other types of taxes, fees, excises, etc. on certain transactions. Some feel that marketplace facilitators should collect all of those taxes to avoid confusing customers while others want to cabin this collection responsibility to sales taxes. There is also disagreement with how to handle the collection of local sales taxes.

8. What sales are included in the nexus thresholds? States have taken different approaches to calculating a taxpayer's sales for purposes of the nexus thresholds. Some include only taxable sales while others include all sales. Some include only direct sales while others include facilitated sales.

9. Should the transaction threshold be eliminated? The South Dakota model noted above evaluates a taxpayer's nexus by looking at both the dollar amount of sales made into the state and the number of transactions that a taxpayer completes with in-state customers. The dollar threshold serves to require tax collection from those who have obtained a certain economic benefit from the state and the transaction threshold serves to require tax collection from those who have repeatedly engaged in commerce with the state. Opinions vary on whether the transaction threshold serves a meaningful purpose for states.

You will see that the MTC Whitepaper also includes comments on these issues from the stakeholders, examples of statutory language from different states, and a variety of letters submitted to the working group. The MTC was also asked to encourage member states to adopt the NCSL model statute, but the MTC declined to do so based on survey responses that it received from states. That correspondence is attached as Appendix E.

Relevant to this group is that the MTC working group did not attempt to create model legislation. Instead its objective was:

> to analyze the prioritized list of issues stemming from states' enactment of legislation imposing sales/use tax economic

> nexus and marketplace facilitator/provider collection requirements, and to present ideas for states to consider to address those issues, with the goal of maximizing tax compliance while minimizing the burden on marketplace facilitators/providers and remote sellers.

The MTC Whitepaper and a wide range of materials, including states' legislation on these issues can also be found online on the MTC's website at www.mtc.gov under the topics "Uniformity," "Current and Recent Uniformity Projects," and "Wayfair Implementation and Marketplace Facilitator Work Group."

The MTC Whitepaper suggested that "states that have already enacted sales/use tax economic nexus and marketplace facilitator/provider collection requirements. . .may be reluctan[t] to make changes to those laws." That has proven to be true and state attention may be more difficult to get at this time given the challenges caused by the COVID-19 pandemic and related public health responses.

III. Potential for Congressional Action

Congress always has the ability to enter this field and to provide uniform rules by virtue of its power to regulate matters affecting interstate commerce. The Supreme Court actually invited Congress to intervene in its 1992 decision upholding the old physical-presence rule, and a number of bills were proposed over the years.[10] The matter proved to be politically intractable, and Congress did not act before the Supreme Court decided *Wayfair*. Since the *Wayfair* decision, a number of bills have been introduced in Congress, but those bills have not appeared to receive any more traction than the pre-*Wayfair* bills.[11] Finding the political will to act on this matter may prove to be particularly difficult given the impact of the COVID-19 pandemic on states' budgets and on Congress' legislative capacity and agenda. In my estimation, the issues appear to be squarely before states at this point.

[10] Congressional Research Service, *Taxation of Internet Sales and Access: Legal Issues*, https://crsreports.congress.gov/product/pdf/R/R43800 (Oct. 1, 2015).

[11] For a general discussion of some of these bills, *see* AICPA, *Federal Legislative Updated on Post-*Wayfair, attached as Exhibit F.