



To: Uniformity Committee
From: Helen Hecht, MTC
Re: Summary of Uniformity Projects & Litigation
Date: December 14, 2015

In line with the Multistate Tax Commission's strategic planning initiatives, this report summarizes important legislative, regulatory, or judicial developments related to models adopted by the Uniformity Committee. The proposed and adopted models referred to in this memo, along with others, are available on the MTC's website (www.mtc.gov) under the Uniformity tab (in either the folder for adopted models or the current and recent project folder).

Model Sales and Use Tax Notice and Reporting Statute
(Currently tabled by the Executive Committee)

The Multistate Tax Commission began drafting the model Sales and Use Tax Notice and Reporting Statute in 2010 based on the notice and reporting statute in Colorado. The draft model would require remote sellers to notify in-state purchasers of a potential tax liability at the time of sale and make annual reports to each in-state purchaser and to the state, subject to non-filing penalties. In 2012, the Executive Committee voted to table further action on the draft pending a decision in *Direct Marketing Ass'n v. Brohl*, a Tenth Circuit challenge to Colorado's statute.

Earlier this year, the Tenth Circuit ruled that the Colorado statute does not discriminate against or burden interstate commerce and that *Quill's* standard does not apply since the information reporting requirements do not require the collection of tax. *Direct Marketing Ass'n v. Brohl*, 814 F.3d 1129 (2016). In August, the DMA filed a petition for certiorari with the U.S. Supreme Court, arguing only that Colorado's law is discriminatory. Colorado filed a reply opposing certiorari, and also filed a conditional cross-petition contending that, if the Supreme Court granted certiorari on the matter, it should take the opportunity to reconsider *Quill*.¹ On December 12, the Supreme Court denied certiorari on both the petition and cross-petition. The denial of certiorari dispenses with the commerce clause arguments, although other potential constitutional challenges remain (including First Amendment challenges that were originally raised by the DNC but were stayed pending the litigation of the commerce clause claims).

¹ The Commission filed an amicus brief in support of that cross-petition.

Oklahoma’s Retail Protection Act of 2016, Oklahoma H. B. 2531 (effective Nov. 1, 2016), gives out-of-state retailers a choice to either voluntarily collect and remit Oklahoma use tax on a prospective-only basis or notify customers of their obligation to remit use tax and provide an annual report of their online purchases. Vermont H.B. 873 adopts “economic nexus” thresholds and Colorado’s customer notification provisions; however, the provision will not be effective until the later of July 1, 2017 or the physical presence test is eliminated by a controlling court. On June 17, 2016, the Governor of Louisiana signed Louisiana H.B. 1121 (effective July 1, 2017), which imposes a notification requirement on remote sellers that have annual Louisiana sales in excess of \$50,000.

Given developments discussed more fully below (under the Sales and Use Tax Nexus Model), it appears likely that more states may look to adopt this information reporting model in the upcoming legislative session.

Proposed Amendments to the Model General Allocation and Apportionment Regulations (Article IV, Sections 1 and 17)
(Pending Bylaw 7 survey)

The Committee completed its work on the draft amendments to implement changes to Article IV adopted by the Commission in 2014—including changes to Sections 1 and 17 (see further discussion below). The majority of these amendments affect the implementation of market sourcing for sales of services and intangibles. As of this date, the proposed amendments are pending results of the Bylaw 7 survey. If a majority of states respond that they would willing to consider adopting those regulations, then they will be placed on the agenda for the Commission to consider.

A few states have indicated that they expect to adopt some or all of the regulations and we expect that trend will continue.

Amendments to Article IV, Section 17
(Adopted by the Commission 2014)

In 2014, the Commission adopted changes to Article IV of the model compact providing for market sourcing of receipts from the sales of services and intangibles. Recent states moving to market sourcing include Nebraska, Rhode Island, Connecticut, Louisiana, and North Carolina (pending). The chart in the following page shows the current status of states with respect to this issue. The statutory rule in a particular state may use one of a handful of different theories for identifying the market for services—location of delivery or receipt, or location of receipt of benefit of the service. The theory for intangibles is typically location of use. Regardless, the rules for implementing the theory have some commonalities: allowance of reasonable approximation, distinction among types of services (e.g. in-person, electronic, business services, etc.), certain default rules (e.g. billing address), and throw-out rules for receipts that can’t be sourced.

Market-Based Sourcing	Market-Based Sourcing	Service Performed	Income Producing Activity/ Cost of Performance
<ul style="list-style-type: none"> • <u>Benefit Received</u> • Arizona (election) • California • Iowa • Michigan • Ohio (CAT) • Rhode Island • Utah • Washington (B&O) • Wisconsin <ul style="list-style-type: none"> • <u>Service Received</u> • Illinois • Maine • Minnesota 	<ul style="list-style-type: none"> • <u>Service Delivered</u> • Alabama • District of Columbia • Louisiana • Massachusetts • Pennsylvania • Tennessee <ul style="list-style-type: none"> • <u>Service Used</u> • Connecticut <ul style="list-style-type: none"> • <u>Customer Located</u> • Georgia • Maryland • Nebraska • New York • Oklahoma 	<ul style="list-style-type: none"> • Colorado • Delaware • New Jersey • Texas (Franchise tax) 	<ul style="list-style-type: none"> • Alaska • Arkansas • Florida • Hawaii • Idaho • Indiana (Benefit) • Kansas • Kentucky (Delivered) • Mississippi (Benefit) • Missouri (Benefit) • Montana • New Hampshire • New Mexico (Delivered) • North Carolina • North Dakota • Oregon • South Carolina • Vermont • Virginia • West Virginia

Based on past trends, it appears likely that more states will move toward market sourcing and may look to use the location of delivery (or something similar) as their basis for doing so.

Sales and Use Tax Nexus Model Act

(Adopted by Commission in 2016)

The project to draft a model sales and use tax nexus statutes began in 2011 and was concluded this year when the Commission adopted the model. Originally, the project was to draft an “affiliate” or click-through nexus model, but was later expanded to a general nexus or “doing-business” model. The adopted model does not “expand” the sales and use tax nexus standard beyond what the committee believed was the majority rule—staying within the standard set by *Quill* and other precedent.

In the meantime, some states have considered and have adopted laws specifically designed to challenge *Quill*. In 2015, the Alabama Department of Revenue promulgated regulation 810-6-2-.90.03, imposing sales and use tax reporting and collection obligations on remote sellers that had at least \$250,000 in retail sales of tangible personal property the prior calendar year. On March 22, 2016, South Dakota signed into law South Dakota S.B. 106 (effective May 1, 2016), imposing a collection duty upon any seller with annual sales in excess of \$100,000 or more than 200 separate transactions in South Dakota. Litigation over expanded nexus has now commenced in both states.²

² South Dakota’s Department of Revenue has a link to documents in the litigation available here: http://dor.sd.gov/Taxes/Business_Taxes/SB106.aspx.

Given recent developments, it seems unlikely that there will be much movement to adopting the Commission's sales and use tax nexus model, with the possible exception of the affiliate nexus provision.

Factor Presence Nexus Standard for Business Activity Taxes

(Adopted by the Commission in 2002)

In 2005, Ohio was the first state to adopt a version of the MTC's factor nexus provision, which establishes a bright-line nexus threshold when a taxpayer's in-state activity exceeds \$50,000 of property; \$50,000 of payroll; \$500,000 of sales; or 25% of total property, total payroll, or total sales. Ohio's factor nexus provision applies to its Commercial Activity Tax (CAT), an annual tax imposed on the privilege of doing business in Ohio, measured by gross receipts from business activities in Ohio. Crutchfield, Newegg and Mason are retail businesses that have no physical presence in Ohio, but had annual Ohio gross receipts in excess of \$500,000. They filed challenges to the statutory standard arguing that the standard violated the dormant commerce clause.³ The cases were consolidated for oral argument, which was held before the Ohio Supreme Court on May 3, 2016. On November 17, 2016, the court held that the \$500,000 sales-receipt threshold set forth in the CAT statute satisfied the commerce clause requirement of substantial nexus. It also found that the *Quill* physical presence requirement does not apply to business privilege taxes.⁴ The time for filing a motion for reconsideration has passed. It is not clear whether the challengers will file a petition for certiorari with the U.S. Supreme Court (which would be due late February and would not be early enough to let the Court hear the case this term).

³ *Crutchfield Corp. v. Testa*, Ohio, No. 2016-Ohio-7760, 11/17/16, *Newegg Inc. v. Testa*, Ohio, No. 2016-Ohio-7762, 11/17/16 and *Mason Cos., Inc. v. Testa*, Ohio, No. 2016-Ohio-7768, 11/17/16. Note – two of the seven justices dissented.

⁴ Some of the Ohio justice's views on the *Quill* issue were reportedly telegraphed during oral argument: "Interestingly, the arguments suggest that the Ohio Supreme Court justices are skeptical about the continued relevance of *Quill*'s physical-presence standard. For example, Justice William M. O'Neill observed that we are living in an 'e-commerce age' and that *Quill* is behind the current state of technology, presumably because technological advances have reduced the burden of complying with tax obligations. Similarly, Justice Judith Ann Lanzinger observed that we are moving away from an analog age toward a digital age. Finally, Justice Paul E. Pfeifer declared that *Quill* is 'ancient' as the world exists today." *Ohio Tax Litigation Reflects Evolving Nexus Landscape*, Jeffrey A. Friedman and Chris M. Mehrmann, Law360, <http://www.law360.com/articles/792718/ohio-tax-litigation-reflects-evolving-nexus-landscape>.