

# Supreme Court to Decide Billion Dollar Sales Tax Case

By Emily Brock and Lisa Soronen

In *South Dakota v. Wayfair*, a state is asking the U.S. Supreme Court to rule that states and local governments may require retailers with no in-state physical presence to collect sales tax.

In January 2018, the U.S. Supreme Court agreed to decide *South Dakota v. Wayfair*, a pivotal case for state and local governments. The State of South Dakota is asking the Supreme Court to rule that states and local governments may require retailers with no in-state physical presence to collect sales tax. This is an extraordinary development for states and local governments that have been waiting for decades for a federal solution to a fundamental challenge: Commerce plows ahead on a 21st-century platform while sales tax collection lags behind on a 19th-century platform. For decades, the marketplace fairness coalition has been stalled, denied the advancement of legislation authorizing the administration and collection of online sales taxes.

In selecting *South Dakota v. Wayfair*, the Supreme Court has signaled to the marketplace fairness coalition and finance officers across the country something that we have known for some time: That this is a current, urgent, and vital topic that must be addressed by the federal government. Now the coalition is faced with two probable solutions — a ruling in favor by the Supreme Court and the advancement of favorable legislation. This article describes the likelihood of advancing.

## THE LEGISLATIVE SOLUTION

**The Remote Transactions Parity Act**. Also important, and related, is key legislation in Congress designed to simplify and standardize tax collection using a 21st-century platform. *The Remote Transactions Parity Act* (HR 2193) authorizes each member state under the Streamlined Sales and Use Tax Agreement (the multistate agreement for the administration and collection of sales and use taxes, adopted on November 12, 2002) to require all remote sellers that don't qualify for a small remote seller exception to collect and remit sales. It also requires them to use remote sales taxes under the provisions of the agreement, but only if that agreement includes minimum simplification requirements relating to the administration of the tax, audits, and streamlined filing.

The bill would compel retailers to collect taxes on remote sales based on the location of the consumer (this is known as destination-based sourcing). The state where the consumer resides could compel out-of-state retailers to collect remote sales taxes, either as a member of the Streamlined Sales Tax Governing Board or through the use of certified software providers. GFOA has long advocated for this legislation, as it outlines key mechanisms detailing the collection and distribution of sales taxes on online purchases.

While there are several compelling reasons why the Supreme Court might

rule in favor of South Dakota (many of which are described below), a key byproduct is that this case clearly motivates Congress to act. It is the nature of Congress to own activities surrounding the Commerce Clause of the United State Constitution, so Congress would likely prefer to be the deciding factor in this case rather than deferring the decision to the Supreme Court. GFOA, along with a large coalition of state and local governments, retailers, and chambers of commerce, stands ready to urge Congress to take this "first mover" advantage.

## AN ANALYSIS IN FAVOR OF A SOUTH DAKOTA RULING

In 1967, in *National Bellas Hess v. Department of Revenue of Illinois*, the Supreme Court held that per its Commerce Clause jurisprudence, states and local governments cannot require businesses to collect sales tax unless the business has a physical presence in the state.

Twenty-five years later, in *Quill v. North Dakota* (1992), the Supreme Court reaffirmed the physical presence requirement but admitted that "contemporary Commerce Clause jurisprudence might not dictate the same result" as the Court had reached in *Bellas Hess*.

Customers buying from remote sellers still owe sales tax, but they rarely pay it when the remote seller does not collect it. Congress has the authority to overrule *Bellas Hess* and *Quill* but has thus far not done so.

To improve sales tax collection, in 2010 Colorado began requiring remote sellers to inform Colorado purchasers annually of their purchases and send the same information to the Colorado Department of Revenue. The Direct Marketing Association sued Colorado in federal court, claiming that the notice and reporting requirements were unconstitutional under *Quill*. The issue the Supreme Court decided in *Direct Marketing Association v. Brohl* (2014) was whether the Tax Injunction Act barred a federal court from deciding this case. The Supreme Court held it did not.

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The State and Local Legal Center (SLLC) filed an amicus brief in *Direct Marketing Association v. Brohl* describing the devastating economic impact of *Quill* on states and local governments. Justice Anthony Kennedy wrote a concurring opinion stating that the "legal system should find an appropriate case for this court to reexamine Quill." Kennedy criticized *Quill* for many of the same reasons stated in the SLLC's amicus brief — specifically, Internet sales have risen astronomically since 1992 and states and local governments have been unable to collect most taxes due on sales from out-of-state vendors.

Following the Kennedy opinion, a number of state legislatures passed laws requiring remote vendors to collect sales tax, in clear violation of *Quill*. South Dakota's law was the first ready for Supreme Court review.

In September 2017, South Dakota's highest state court ruled that the South Dakota law is unconstitutional because it clearly violates *Quill*, and it is up to the U.S. Supreme Court to overrule *Quill*. In October 2017, South Dakota filed a certiorari petition asking the Supreme Court to hear its case and overrule *Quill*. The SLLC filed an amicus brief supporting South Dakota's petition. The Supreme Court ultimately agreed to decide the case.

For a number of reasons, it seems likely the Supreme Court will rule in favor of South Dakota and overturn *Quill*. It is unlikely the Supreme Court accepted this case to congratulate the South Dakota Supreme Court on correctly ruling that South Dakota's law is unconstitutional — that is, if the Supreme Court wanted to leave the *Quill* rule in place, it probably would have simply refused to hear *South Dakota v. Wayfair*.

It is easy to count at least three votes in favor of South Dakota in this case. First, of course, is Kennedy. Second is Justice Clarence Thomas; while he voted against North Dakota in *Quill*, he has since entirely rejected the concept of the dormant Commerce Clause, on which the *Quill* decisions rests. The third vote would be from Justice Neil Gorsuch. The Tenth Circuit ultimately decided in the *Direct Marketing Association v. Brohl* ruling that Colorado's notice and reporting law didn't violate *Quill*, and then-judge Gorsuch wrote a concurring opinion

strongly implying that given the opportunity, the Supreme Court should overrule *Quill*.

That said, the Supreme Court, and Chief Justice John Roberts in particular, is generally reticent about overturning precedent. The *Quill* decision illustrates as much. The Supreme Court looks at five factors in determining whether to overrule a case, one of which is whether a rule has proven "unworkable" and/or "outdated . . . after being 'tested by experience.'" This factor weighs strongly in favor of overturning *Quill*. As Kennedy pointed out in *Direct Marketing Association v. Brohl*: "When the court decided *Quill*, mail order sales in the United States totaled $180 billion. But in 1992, the Internet was in its infancy. By 2008, e-commerce sales alone totaled $3.16 trillion per year in the United States."

## CONCLUSIONS

The court will hear this case during this term, which means that it will issue an opinion by the end of June 2018. Until then, GFOA will continue to work closely with its colleagues at the National League of Cities, U.S. Conference of Mayors, National Association of Counties, and National Governors Association, along with its partners in the retail community, to urge Bob Goodlatte (R-Va.), chairman of the House Committee on the Judiciary, to consider moving forward with solutions like *The Remote Transactions Parity Act* that use destination-based sourcing to determine the tax. As congressional discussions continue following the Supreme Court's decision to hear South Dakota v. Wayfair, GFOA will keep you informed on their status, and continue to encourage you to engage your members of Congress directly in order to urge their support for remote sales tax legislation.

### The Truth about Marketplace Fairness

Although *Quill Corp. v. North Dakota* holds that a state may not require a seller that does not have a physical presence in the state to collect tax on sales into the state, online buyers in states that impose a sales tax (45 states and the District of Columbia) are already required to pay a use tax for items upon which no sales tax has been paid. Sellers do not always apply this tax, and most buyers are not aware of their obligation to remit it, creating increasingly negative fiscal consequences for state and local governments as a greater number of consumers have begun to shop online. According to the Department of Commerce, e-commerce sales in 2005 were $87 billion, and that number grew by nearly 40 percent to $225.5 billion in 2012. These sales produced approximately $23 billion in unpaid sales and use taxes in 2012, according to the National Conference of State Legislatures.

Opponents of the *Marketplace Fairness Act* argue that even if technology can resolve the technical concerns of keeping track of rates, jurisdictions, and filing complexities, such software would be prohibitively costly, particularly for small businesses. However the legislation actually requires states to provide the necessary software to retailers at no cost. And business has been very involved in simplifying the sales tax systems across the country to make it easier to comply. These improvements include standard definitions, taxability tables, and other improvements that the software can interpret at the time of sale. It has already gotten easier for small businesses to comply with their sales tax responsibilities.

Technology has advanced considerably since the 1967 and 1992 Supreme Court rulings that created the current sales tax situation. Today, keeping track of a few thousand local tax rates and filing requirements is not an insurmountable technical, administrative, or financial burden. The technologies necessary to create such a system are well established. In fact, they are currently being used throughout e-commerce, with existing technology available from at least six companies that allows for the easy collection of due sales tax.

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