





# Collecting Sales Tax on Remote Commerce—the Work Continues

BY MIKE BAILEY

In the past, tracking sales tax trends primarily consisted of knowing your tax laws, your local economy, and the retail business community. But the function has evolved over time, and now finance officers need to know more about how remote sales (as in goods purchased from businesses outside your jurisdiction that are delivered to businesses or households in your community) are subject to either a sales or use tax obligation.

The U.S. Supreme Court's 2018 decision in *South Dakota v. Wayfair, Inc.* [*Wayfair*] removed one of the barriers to collecting taxes on remote sales, and it has significantly affected this aspect of remote commerce on state and local government revenues. While many of us thought the COVID-19 pandemic recession would have a negative impact on sales tax collections, the combination of the Supreme Court's decision and the dramatic increase in remote sales activity has resulted in an increase in these revenues for many governments.

In this article, we will briefly retrace the evolution of taxing remote sales and then examine some of the current issues, trends, and concerns that remain in this increasingly important part of our local economies.

## A quick review

For many years, states and local governments were unable to enforce the collection of their sales taxes on remote sales because of a Supreme Court case known as *Quill Corp. v. North Dakota* (*Quill*). This 1992 case affirmed the decision in the 1967 *National Bellas Hess v. Department of Revenue of Illinois* (*Bellas Hess*) case, in which the Supreme Court determined that only businesses with a *nexus*—a *physical presence*—in a state must collect sales tax for that state.

The court determined that the complications of knowing the tax laws and reporting taxes without a nexus represented an “undue burden” on interstate commerce. Consequently, the application of state and local sales taxes focused on the issue of physical presence for many years. But in the *Wayfair* ruling, the Supreme Court struck down the physical presence requirement originally imposed by *Bellas Hess*.

In the *Wayfair* decision, the Supreme Court did not determine that state and local sales taxes were equally enforceable within and beyond the boundaries of a jurisdiction; it merely eliminated the physical presence requirement. In its ruling, the court was careful to point to certain elements of the South Dakota law that were relevant to its decision, including a safe harbor for those with limited sales in the state, no retroactive collection of remote sales taxes, and a reduced burden of collecting these taxes on behalf of the state. The court noted that South Dakota was part of the Streamlined Sales and Use Tax Agreement (SST), which resulted in efforts to lower the burden of collecting the taxes on remote businesses. These considerations were seen as effective enough in reducing the undue burden to interstate commerce that physical presence (nexus) was no longer the “bright line” precluding the state from enforcing its sales tax collection obligations on remote sellers in the State of South Dakota.



Eliminating the physical presence requirement and the increase in remote commerce has had a dramatic effect on local government budgets.

As a result of the *Wayfair* decision, every state with a sales and use tax has adjusted its laws and imposed a requirement for remote sellers to collect their sales taxes under certain circumstances. (although the State of Missouri's law is not effective until January 1, 2023). These changes affected the related local government sales tax collections as well. Consequently, there has been a significant increase in tax collections on remote sales.

Since the *Wayfair* decision, the number of sellers registered through the Streamlined Sales Tax Registration System has increased by more than 400 percent to more than 16,000 sellers. SST member states saw their collections from SST-registered sellers increase to more than \$2.5 billion per year in 2020, with approximately 50 percent of those dollars coming from remote sellers, based on information the states have provided to Streamlined Sales Tax™ Governing Board. The SST program continues to grow and has been realizing a net increase of 200 to 300 new seller registrations each month. As sellers become aware of the requirements to collect and remit the applicable state and local sales taxes on their remote sales, the number of sellers and revenue collected are expected to keep climbing.

### Impact on local government sales tax collections

U.S. local government sales taxes are administered in many ways. The court cited one simplification in *Wayfair* that appeared to reduce the undue burdens on sellers' interstate commerce sales was that the state administered all sales taxes for South Dakota local governments, helping to simplify the tax administration burden for businesses selling into the state. Some local governments administer their own sales taxes, both alongside a state sales tax and in states with no state-level sales tax. The court also noted simplifications in tax administration including uniform definition of products and services subject to the tax and a simplified rate structure. Again, these examples can take different forms in local governments across the country.

The court's decision in *Wayfair* leaves open the potential for challenges to the enforcement of taxation on remote sales when the fact patterns begin to diverge from those in South Dakota. It remains unclear to what extent the unfair burden of imposing a local sales tax on a business might be influenced by such elements as local tax administration and multiple

tax rates or different product definitions (to name a few). Therefore, local governments that are administering their own local taxes, rather than having the state administer them in a manner consistent with how the state taxes are administered, may be at risk for imposing undue burdens on interstate commerce.

## COVID-19 and the importance of remote commerce

GFOA has been involved in this issue for many years. The changes in retail commerce have reinforced how important this issue is, as we continually trend toward a more remote, or online, retail sales economy. Many governments were initially quite concerned about the negative impact the pandemic-related recession would have on their revenues. The level of retail activity created by state-mandated stay-at-home orders or lockdowns became an immediate concern. Trying to predict the impact of the pandemic on related sales and use tax receipts suddenly became a real challenge for state and local finance officers, but we have since learned that there was still a significant amount of retail activity; it simply moved to a remote-commerce approach.


As a budget reviewer for the GFOA's Distinguished Budget Presentation Program, I look at lots of local government budgets across the United States (and Canada). In reviewing hundreds of budgets each year, I've noticed that many local governments have been identifying the increased risk associated with the pandemic's unknown impact on tax revenues. In many cases, governments implemented cost saving or budget-reducing measures as a result. More recently, however, I see budgets citing the significance of remote sales on bolstering their tax revenues, and we have come to realize how important this shift in commerce has become in our budgets. The convergence of eliminating the physical presence requirement (as a result of the *Wayfair* decision) and the increase in remote commerce has had a dramatic effect on local government budgets—and the trend toward online commerce is expected to continue.

## Challenges remain

These modernizations in commerce and tax policy have resulted in a change that is positive overall, although some challenges remain. The evolution of commerce brings with it new issues. For example, a current topic on the Streamlined Sales Tax State and Local Advisory Committee (SLAC) agenda is the proper sourcing of the sale of digital goods. If a purchaser buys the use of a digital good (such as software or access to a digital resource), how does that sale get properly recorded for tax purposes? Where did the sale occur?

And based on that, what is the correct tax rate, and which jurisdictions get the resulting tax?

The businesses and states involved are genuinely interested in getting the correct answer to these questions. They want to do the right thing. They also want the proper administration of this tax collection obligation to be simple, as standard as possible (from jurisdiction to jurisdiction) and streamlined. These discussions continue for months and become tedious in their detail, but problems and mistakes will occur without this level of clarity. Multiple jurisdictions may claim a right to the tax, the business may collect the tax using the wrong tax rate (or no tax at all), and consumers will complain that the business is collecting taxes from them inappropriately (or worse, participate in a class-action lawsuit that becomes very expensive for everyone).

To preserve the benefits of the *Wayfair* decision, state and local governments should continue to work together and with their business communities to assure that the burden of collecting state and local taxes remains reasonable. This work requires a healthy partnership among the parties that are willing to work toward the larger goals. Businesses want to be able to do the right thing, and to do so as easily and economically as possible. States and local governments want to be able to collect taxes on economic activity within their jurisdictions so they can provide services to their communities. Consumers want to be assured that the retailer is only collecting the taxes that are legally owed and that the taxes go to the proper jurisdictions. 

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The local government perspective on these issues is represented at the SST through the National League of Cities, National Association of Counties, US Conference of Mayors, and GFOA. Individual representatives from members of these organizations have participated in the discussions for many years. It is important to continue this collaborative participation. **If you are interested in learning more about how to contribute to these efforts or have issues that you would like SST to address, please contact Streamlined's Executive Director, Craig Johnson at [craig.johnson@sstgb.org](mailto:craig.johnson@sstgb.org).**