Behind the Supreme Court Case That Gives States Ok to Tax Internet Sales | OAS Episode 35 | June 28, 2018

Welcome to “Our American States,” a podcast of meaningful conversations that tell the story of America’s state legislatures, the people in them, the politics that compel them, and the important work of democracy. For the National Conference of State Legislatures, I’m your host, Gene Rose.

On June 21, the United States Supreme Court issued an historic ruling for state governments in the case South Dakota v. Wayfair. The court granted states the authority to collect taxes on online purchases made by state residents.

The National Conference of State Legislatures has worked for more than 25 years to bring fairness to brick-and-mortar retailers who are forced to collect those taxes while online retailers are not. The reason is two U.S. Supreme Court cases which our guests today will reference.

The first, National Bellas Hess v. the Department of Revenue of Illinois in 1967, stated that business only had to collect sales taxes if they had a physical presence in the state. In 1992, 25 years later, in Quill v. North Dakota, the court reaffirmed the Bellas Hess decision on physical presence, but left the door slightly ajar for a future challenge.

The new ruling set some standards which the court said South Dakota met for collection of sales taxes on online purchases. Several major online retailers have been collecting taxes in recent years in anticipation of such a decision.

To explain the history of this decision and what policy implications are at stake, we will hear from two experts at NCSL. First we will talk to NCSL Executive Director, William Pound, and then Max Behlke, who has led staff efforts in recent years on this issue.
We have as our guest now the executive director of the National Conference of State Legislatures, William Pound. Bill, can you explain to us what the Supreme Court decided in this case?

Bill: Well, the key issue here was whether the physical presence rule, which the court had applied in a couple of earlier cases, one from the 1960s in National Bellas Hess v. Illinois, and then again in the early 90s in Quill v. North Dakota, that said that in order for a state to collect sales taxes from a business, the business had to have a physical presence in the state. And physical presence has been defined to be, as you might think it is, a building, whether rented or owned, an actual operation within the borders of that state.

The court overturned that precedent, reversed it, and said that you don’t have to have physical presence or that physical presence can be defined in other ways, and that South Dakota in this case had sufficiently defined the other way, without having the physical presence, building, what-have-you in the state.

Gene: You all have been working on this for a long time. Did the states get everything that they wanted from this decision?

Bill: They got most of what they wanted, yes, because the physical presence rule was the key to a lot of this. The court could have only limited the decision to South Dakota and their particular set of consequences but they did not, or they could have gone partway, but they pretty much have opened up the ability of the states to tax businesses that are doing business in the state, whether it’s electronically or it’s a main street business.

Gene: As I mentioned before, you've worked on this for a long time, probably since the Quill decision in 1992. Is that right?

Bill: That is correct. The concern about it grew after that decision in the early 90s and, of course, this was really before the advent of the internet or commerce over the internet, and if you remember, many people will, that one of the major businesses that used to be fillers in your magazine or newspaper was film developing: mail it in and we'll develop it and you don’t pay sales tax and that. When states began to get active, people like that who had access to advertising would tack on to their own ads opposition comments, that this was unfair, that you shouldn’t do it.

So, as a result of that and with the advent of the internet, we formed a taskforce in the late 90s, about 1998 actually, to look at this, which became the State and Local Tax Taskforce. The other organizations did as well. There was a national commission to look at this and it held a set of hearings and did not result in a satisfactory decision or result for state and local government, and we have pushed on ever since then.

NCSL was in the lead in the beginning of helping form the state and local effort. We were not, all the groups, always together and there were differences in questions like who would collect, because we’ve always felt that in order for it to be successful, there had to be one point of collection, meaning the state, not a multitude of localities. And also we needed to do some harmonization of sales tax rates because many states have a variety of state and local tax rates depending on jurisdiction.
But we have been at that ever since then. A number of legislators and our staff have done, I think, yeoman work in carrying the matter through to this point.

Gene: So why was this such an important issue, Bill? Was it a fairness issue for the states?

Bill: It is a fairness issue. It’s so important because the movement of commerce to the electronic means to the internet means that the traditional means of purchasing things on which you paid a sales tax to state and/or local government, was a declining revenue source for most jurisdictions. The decline picked up speed over time and it was clearly going to go that way even more as we see the percent of commerce that is electronic growing by the year.

So that was why we felt we had to do something about it and it was disadvantaging the main street merchant. Main street fairness has been the term applied to this so much of the time.

Gene: What happens next, Bill? Do you continue to work on this issue? Do you think you’re going to have the support of Congress as this continues?

Bill: Well, there are a couple of questions there. One, we will continue to work on it, yes, very definitely. Twenty-four states have joined the streamlined sales tax effort. It’s a model act where the states agree on how they would collect. They agree that there won’t be numerous audits. They agree they won’t be retroactive and attempt collection.

So that will continue and I would expect some more states will join that effort. And that was a joint effort of ourselves, the National Governors Association, the organizations of revenue administrators across the country. The key thing I think coming forward will be helping states comply with the Supreme Court decision, because the Supreme Court said what South Dakota had done was sufficient to comply with a fair system of collection of e-commerce.

But that doesn’t mean that every state will come up with that, because South Dakota exempts certain volumes of sales, certain numbers of transactions – if you don’t meet that threshold, you don’t have to collect – and that is an attempt to protect particularly small sellers over the internet.

We anticipate that there will be a good deal of effort on compliance in the coming year. Several states in the last year or two, particularly since South Dakota filed this suit, have in anticipating that the Supreme Court might do what they did and hoping that they would do what they did, set in place a set of regulations that probably comply pretty well with what the tenor of the court’s opinion is, that would make the collection meet the necessary test of presence in the state.

Gene: As you continue to work on this issue, how many states do you think will be adjusting their policies in order to take advantage of the Supreme Court decision?

Bill: Well, I think that all of the streamline states will look to see if there’s anything more they need to do, and I think several other states, a number of them, maybe gradually, just as has been the case with complying with some of the changes in the federal tax law at the beginning of this year in the tax reduction act, that the states will over a period of time... it could be six months; it
Gene: And what else should state legislators across the country and staff know about this issue in preparation for next year’s legislative sessions?

Bill: Well, one of the things they need to look at is: What action does Congress take? Because the court clearly left the door open; they said Congress can legislate in this area, certainly under the commerce clause. Now, Congress has not been a favorable scene for the states on this or many other things recently, but it’s a question whether they can come up with anything that would affect this decision, in other words, try to limit it in some way, or essentially overturn it legislatively, which they could, though I think that is very unlikely with this Congress just judging by the fact that they haven’t been able to get a majority to do anything that would have enabled it over the last ten years.

It’s difficult to think that right now, at least through the election, through the end of 2018, that that situation will change. Now, with a new Congress, whatever it may look like, that could be different and we will have to watch that front very carefully and make sure we maintain the latitude for the states that the court said they should have here.

Gene: We’ve been talking with Executive Director of the National Conference of State Legislatures, Bill Pound. Bill, thank you for sharing your expertise on this issue.

Bill: Certainly.

Music

Gene: Max Behlke, who is the Budget and Tax Director of the National Conference of State Legislatures State-Federal Relations Department in their Washington, D.C. office, joins us again as a guest on “Our American States.” Max, we talked earlier with Executive Director, Bill Pound, about this court ruling. You’ve been working with NCSL’s Executive Committee Taskforce on State and Local Taxation for a number of years on this issue. What was your first reaction when you heard the Supreme Court decision?

Max: It was relief. It was kind of surreal. It was kind of unbelievable. It’s hard for me to put words to it. But it’s just such a relief for states and for the brick-and-mortar retailers across the country to finally be able to compete on a level playing field. It’s really a remarkable event.

Gene: So walk us through the finer points of the court’s ruling. What reasons did they give to support your position on this?

Max: In the 5-to-4 decision, which did not break on ideological lines... Justice Ginsburg joined with Justice Thomas, Justice Gorsuch, Justice Alito and Justice Kennedy, and they said that South
Dakota had met the simplification requirements and their law did not impose an undue burden on interstate commerce.

What’s really interesting as well though – even in the dissenting, the four justices that joined the dissent – all four of them said that: we agree that Quill was a bad law; what we did in 1992 was not correct. However, they believe that it is Congress’ place to actually come in and address this. So in that aspect it was a 9 and 0 decision validating that Quill was a bad law.

But what’s more interesting about the case itself – it was not a complete overturn of Quill. Quill said that you had to have a physical presence in a state in order for that state to require you to collect to remit that state sales tax. While the decision did toss out the physical presence standard, it did say that what South Dakota had done did relieve the burdens on interstate commerce, such as they were a member of the Streamline Sales and Use Tax Agreement; they had simplified their sales tax base and administration; they said they weren’t going to apply their law retroactively, which was a very big point in the 1992 case.

Every state will have to look at their laws and go forward and see that if their law has met the same standard that South Dakota had, and that is true for some states. Some states have already passed South Dakota-style legislation, while others are going to have to take a much harder look and possibly change their laws in the next legislative session to make sure that they don’t get challenged and say that what they did is really different than South Dakota’s going forward.

Gene: So you work with state legislators across the nation on this issue. What’s going to happen when legislators go back into session next year?

Max: Next year is going to be a huge year for state and local tax activity in state capitals. We’re not that far removed from the Tax Cuts and Jobs Act, the federal tax reform bill that passed in December of 2017. Next year is going to be a bigger year for conforming with that on the state level than it was this year, so they have that.

Now they have remote sales tax to handle and what does that mean for their revenues and how are they going to apply it? So I think those discussions are going to happen in tandem: What kind of additional revenues is it going to mean to our state? What kind of laws do we want to move forward as the $100,000 threshold for when a retailer has to collect to remit in our state? Is that the threshold that we want to enforce?

While we’re opening up our tax code for corporate tax reform and personal income tax as well as sales tax, do we want to have a bigger overhaul and do comprehensive tax reform on the state level all at once?

I don’t think we’re going to put all the states into one bucket and say they’re all going to do this. I think it’s going to be a state-by-state case. I think we’re going to have states move forward in the next 60 days, while other states may wait a year or two to move forward. So it’s going to depend on what the political dynamics are in each state, what goals they’re trying to achieve, and what policymakers really would like to have as an ideal tax code for their state.
Gene: So what’s this going to mean for consumers, Max? Are they going to notice something right away, or is it going to be delayed because of the legislation that you’ve been talking about?

Max: It’s going to depend on where they’re buying from. I’m sure that everybody that’s listening to this, seeing it’s the state legislatures’ podcast, that everybody is already voluntarily remitting all the taxes they owe for their online purchases to their state each year. (chuckle) Okay, maybe not.

So if you’re like me and you do voluntarily remit the taxes that are owed to your state, it actually is going to make it a lot easier because I don’t have to keep track of that throughout the year. But what it means for consumers themselves, it depends on what state they live in and how quickly they move forward.

Yesterday it came out that Overstock will begin collecting in every state in the country for sales taxes. So I think we’re going to see more companies progressing along that line as states start to move forward and start collecting. But for the most part, Gene, consumers don’t shop online because of sales tax avoidance. They do so out of convenience. However, when there’s the same product and you have the option of not having to pay tax on one website where you do with the other, I think those consumers will realize that tax is going to be applied no matter where they buy it from and that those decisions will no longer be taken into account.

I honestly think in a year or two that we’re going to look back and no one is even going to remember the time that we didn’t have sales taxes that weren’t applied to online sales. I think that states are very cognizant that they have to do this correctly, that if they make mistakes or they make bad headlines and put penalties out there for sellers that are trying to collect, they understand that Congress could come in and preempt their authority.

So it’s in the best interest for states to have a well-thought-out, well-executed sales tax regime that applies to remote sales rather than rushing into it and making mistakes, because as I’ve been saying, states have waited 26 years for this authority; waiting a few more months for the sake of good public policy is fine. So I think that’s really what we’re going to see in the long term. We’re going to see over the coming weeks, over the coming months as states start to grasp this on their own, they’ll make sure that it’s done right.

Gene: And are there other policy considerations that this court ruling is going to bring out that you hadn’t already talked about, Max?

Max: I don’t think so. I think that there was concern that this would apply to certain types of income tax. I don’t believe that that’s really going to happen. I think what this does is it codifies what’s existed for every other type of tax out there, that for income tax purposes, physical presence hasn’t mattered for years. And I think that’s going to be the same going forward, that the 21st century economy and the way that we shop, the way that we interact with one another, the way that we work, physical presence is no longer a valid standard in the 21st economy.

So I think that the court’s recognition of this really shows going forward that we’re in a different world now than we were just a couple of decades ago, and that when you set yourself to a mark, it doesn’t mean you have to be there going forward.
Gene: So let me get you out on this. As state legislators prepare for the next year, where can they go to get additional resources and will NCSL keep continuing to work on this project?

Max: Oh, of course. We have a great remote sales tax page on ncsl.org that has gone through all the state activity, what different states have done, where they’re going forward, and contact information for myself and my wonderful tax colleagues, or fiscal affairs colleagues at NCSL. We’ll gladly state what stat is it out ther, and just in any aspect that they need to move forward to make sure this is done correctly because tax administrators want good tax policy to enforce and the business community/consumers want good tax policy to follow and to adhere to.

So I encourage state legislators and staff to really reach out to us and we will provide them probably with more information than they ever thought there could possibly be on this topic.

Gene: We’ve been talking with Max Behlke, the Budget and Tax Director for NCSL’s State-Federal Relations Department in the Washington, D.C. office. Max, thanks for sharing your perspective on “Our American States.”

Max: Thank you very much, Gene. It was a pleasure being on today.

Music and Gene VO:

And that concludes this edition of “Our American States.” We invite you to subscribe to this podcast on iTunes and Google Play. Until our next episode, this is Gene Rose for the National Conference of State Legislatures. Thanks for listening.