

# A Question of Fairness

Years of work to simplify the collection of remote state sales taxes may soon pay off.

BY MAX BEHLKE

**A**fter 16 years as a photojournalist for the Las Vegas Review-Journal, Wayne Kodey finally realized his life's dream when he bought his favorite camera store in Las Vegas in 1995. With the internet still in its infancy and customer service his top priority, Kodey's business thrived. Over time he was able to expand and hire more employees.

As the internet matured, however, the shopping habits of Kodey's price-conscious customers changed. Many spent hours with Kodey's employees, learning how to use various aperture settings, filters and lenses, only to politely thank them for their time then leave to purchase the camera online to avoid the 8 percent sales tax. One brazen shopper even used his phone to buy a camera online before leaving the store.

"The price advantage of 8 percent on a \$2,000 camera was \$160—a large gap in today's price-conscious environment," Kodey told a Nevada Assembly committee in 2017. Competition from online sellers gradually eroded his customer base, he said, until he finally had to sell his store in 2013.

"Leveling the playing field would

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## Three Scenarios

If the U.S. Supreme Court ends up hearing the *South Dakota v. Wayfair* case, most observers expect it to issue one of three rulings.

**1. The court upholds *Quill*.** This would be the worst-case outcome for South Dakota and the 35 other states that joined its petition. Given the continual growth in e-commerce, if states are unable to collect taxes on internet purchases, the sales tax would most likely no longer be a viable revenue source for states. This would be the preferred outcome for those who support higher income and property taxes over sales taxes, however.

**2. The court issues a narrow ruling.** The court could rule the South Dakota law constitutional but not comment on the broader issue. While this outcome would indeed be a victory for South Dakota, it could mean that other states would have to pass similar laws or else risk legal challenges.

**3. The court overturns *Quill*.** This would be the best outcome for the states. It would allow them to begin enforcing their tax laws for products sold within their boundaries. States would build upon their collaborations that ultimately developed the Streamlined Sales and Use Tax Agreement to ensure a smooth implementation of tax collection and remittance.

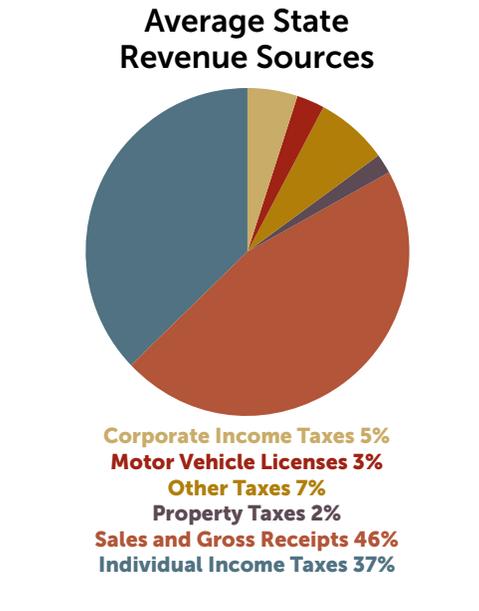
have made it possible to continue our business and save those employees their jobs and health benefits,” he said.

Similar stories abound. The owner of a baby products store in New York tells of a woman who asked him to show her how to assemble a crib. After an hour with her, he learned that she had already bought the crib online to avoid paying the sales tax and just wanted to learn how to put it together.

Then there’s the congressman’s wife who owns a wedding dress boutique. She spent hours with a bride-to-be, helping her find the perfect dress, only to have her walk out to buy the same dress online, tax free. A few days later the audacious bride brought the dress into the store for alterations.

### Is All This Fair?

These stories raise the question: Why are out-of-state retailers allowed to skirt the state sales tax laws that stores on Main Street must adhere to? It’s a question of fairness, as NCSL and many state lawmakers see it, and one that led to *South Dakota v. Wayfair*, the case the U.S. Supreme Court is scheduled to hear on April 17. At press time, however, the future of the case was uncertain. Congress was debating the idea of including a remote sales tax



collection bill in the omnibus budget bill to be considered before March 23. If successful, such legislation would likely end the Supreme Court process on the South Dakota law, and whether that would be better for states is debatable.

If the case does go to court, and South Dakota prevails, it’s possible that, for the first time, the state will be able to enforce their sales tax laws on all purchases made by their residents. If the state loses, the long-term viability of the sales tax as a revenue

## The Long and Winding Road



May 26, 1992

In *Quill Corp. v. North Dakota*, the U.S. Supreme Court rules that only businesses with a physical presence in a state should be required to collect its sales taxes.



Aug. 11, 1994

One of the first secure retail transactions occurs over the internet when NetMarket sells a copy of Sting’s “Ten Summoner’s Tales.”



July 16, 1995

Amazon sells its first book online.



April 8, 1999

NCSL’s newly formed Task Force on State and Local Taxation meets for the first time.



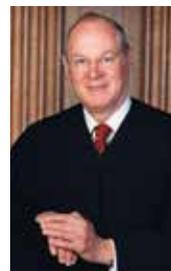
December 2002

The NCSL task force adopts the Streamlined Sales and Use Tax Interstate Agreement.



March 22, 2013

The U.S. Senate overwhelmingly passes the Marketplace Fairness Act.



March 2015

Supreme Court Justice Anthony Kennedy welcomes a reconsideration of the *Quill* decision.



Jan. 27, 2016

South Dakota Senator Deb Peters (R) introduces Senate Bill 106 to require large remote sellers to collect and remit the state’s sales tax.

source for states will be in grave jeopardy.

South Dakota's trek to the Supreme Court began with its neighbor to the north. In the early 1990s, Quill Corp., an Illinois-based office supply retailer, was one of the country's most successful mail-order operations. In addition to its extensive catalogue of low-priced products, Quill had the competitive advantage of being able to avoid collecting sales taxes in the states where it had no physical stores.

This tax advantage upset brick-and-mortar, Main Street retailers who had to compete against large, out-of-state companies. Why, they asked, should an out-of-state company receive a competitive advantage over in-state, job-creating businesses like theirs?

The state of North Dakota filed an action in court to force Quill Corp. to collect the state's sales tax, even though it had no offices or employees in the state. Ultimately, the case, *Quill Corp. v. North Dakota*, worked its way to the U.S. Supreme Court. In 1992, the court ruled that requiring businesses to collect and remit sales taxes for states where they had no physical presence would "unduly" burden interstate commerce.

The court reasoned it was too complicated for sellers to comply with so many different state sales tax systems. The court

also urged Congress to pass legislation to fix the problem. In the 26 years since the ruling, Congress has failed to act. The problem from the states' perspective has only worsened with the tremendous growth of electronic commerce.

**Is Quill Just Too Old?**

The trouble with the *Quill* decision is its age. Since 1992, technological advancements have fundamentally transformed nearly every aspect of our lives, including the ways we shop and collect taxes.

The *Quill* decision, in fact, came two years before the first secure retail transaction occurred over the internet and three years before Amazon and eBay were launched in 1995. Even Quill Corp. didn't start selling online until 1996.

Now, e-commerce is flourishing. It accounted for 8.9 percent of U.S. retail sales in 2017 and is growing five times faster than offline sales. In fact, e-commerce is expected to grow to almost \$500 billion in the U.S. alone in 2018.

The inability to collect taxes on these online purchases is threatening the viability of the sales tax as a revenue source for the states. Although convenient for the buyer, internet sales have diminished state sales tax revenue by billions of dollars. A joint study by NCSL and the

International Council of Shopping Centers estimated that states collectively lost \$26 billion in uncollected sales and use taxes in 2017. The problem is especially acute for the several states, like South Dakota, that do not levy corporate or personal income taxes and rely primarily on sales taxes to fund vital government services.

**Streamlining and Modernizing**

After *Quill*, "states came together to identify the issues they needed to address to modernize and simplify their tax codes in the internet age," former Illinois Senator Steve Rauschenberger said. He was the first Republican co-chair of the task force created by NCSL's Executive Committee in 1999 to study the issue and monitor the newly established Federal Advisory Commission on Electronic Commerce.

"This was an issue of fiscal federalism and state sovereignty," Rauschenberger said. "We felt strongly that if states could streamline sales and use tax administration, Congress would recognize our efforts and grant us the authority to enforce our tax laws."

The task force adopted a set of principles that led to the creation of the Streamlined Sales Tax Project to simplify and modernize sales taxes in the states. After



**March 22, 2016**  
South Dakota Governor Dennis Daugaard (R) signs S.B. 106 into law.



**March 25, 2016**  
The South Dakota Department of Revenue sends notices to 206 retailers to register for a license to collect and remit state sales taxes by April 25, 2016.



**April 28, 2016**  
South Dakota files "declaratory judgment" against online retailers Wayfair, Overstock and Newegg for violating S.B. 106.



**Jan. 4, 2016**  
*State Tax Notes* names NCSL's Task Force on State and Local Taxation its Tax Organization of 2016.



**March 6, 2017**  
The South Dakota 6th Judicial Circuit rules S.B.106 unconstitutional.



**Sept. 13, 2017**  
The South Dakota Supreme Court upholds the lower court's ruling.



**Oct. 2, 2017**  
South Dakota petitions the U.S. Supreme Court to hear the case.



**Jan. 12, 2018**  
The Supreme Court grants South Dakota's petition.



**April 17, 2018**  
The Supreme Court is set to hear oral arguments in the case.

### The Trump Administration Sides With States

Solicitor General Noel Francisco urged the U.S. Supreme Court to expand states’ authority to collect sales taxes on internet transactions in a friend-of-the-court brief filed on March 5. “In light of internet retailers’ pervasive and continuous virtual presence in the states where their websites are accessible, the states have ample authority to require those retailers to collect state sales taxes owed by their customers,” Francisco wrote. “The court should resolve this case by making clear that an out-of-state internet retailer’s virtual presence within a state is a sufficient ground for requiring the retailer to collect sales or use taxes owed by its in-state customers.”

two more years of work, in coordination with the National Governors Association, the Federation of Tax Administrators and the Multistate Tax Commission, the task force voted unanimously to accept the Streamlined Sales and Use Tax Interstate Agreement in December 2002.

More than half the 45 states that levy a sales tax, along with Washington, D.C., eventually signed the agreement, which would have minimized the undue costs and administrative burdens experienced by retailers that had to collect sales taxes in several different states.

These “streamlined” states, as they became known, simply needed Congress to grant them the authority to enforce the agreement. Now, 16 years later, the wait may be over, but the timing is poor. States will most likely benefit more from a Supreme Court ruling than any language Congress agrees to insert into the federal budget bill.

The first e-fairness bill in Congress was introduced by Senators Mike Enzi (R) of Wyoming and Byron Dorgan (D) of North Dakota. Called the Streamlined Sales and Use Tax Act of 2003, it would have granted states the authority to require out-of-state sellers to collect and remit sales taxes, but the bill never received consideration.

A decade later, however, the U.S. Senate overwhelmingly passed the Marketplace Fairness Act, sponsored by Enzi and

Illinois Senator Dick Durbin (D). It would have granted streamlined states, as well as states that complied with certain simplification requirements, the authority to collect the taxes they are owed. But it languished in the House Judiciary Committee without receiving a hearing, as has a recent, more substantive proposal, the Remote Transactions Parity Act.

State lawmakers felt they had exhausted nearly every path to a solution—until March 2015. That’s when Supreme Court Justice Anthony Kennedy threw them a lifeline. In a concurring opinion on another state tax case, Kennedy, who is one of only two justices still on the court since hearing the *Quill* case, wrote: “Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court’s holding in *Quill*. A case questionable even when decided, *Quill* now harms states to a degree far greater than could have been anticipated earlier.”

This sparked states into action once again.

In January 2016, the NCSL Task Force on State and Local Taxation sent a letter to

every state that levies a sales tax, suggesting options for them to consider to help solve the remote sales tax problem. Since then, 15 states have enacted legislative measures aimed at requiring out-of-state companies to collect and remit applicable taxes.

One of those states is South Dakota.

### From Legislation to Litigation

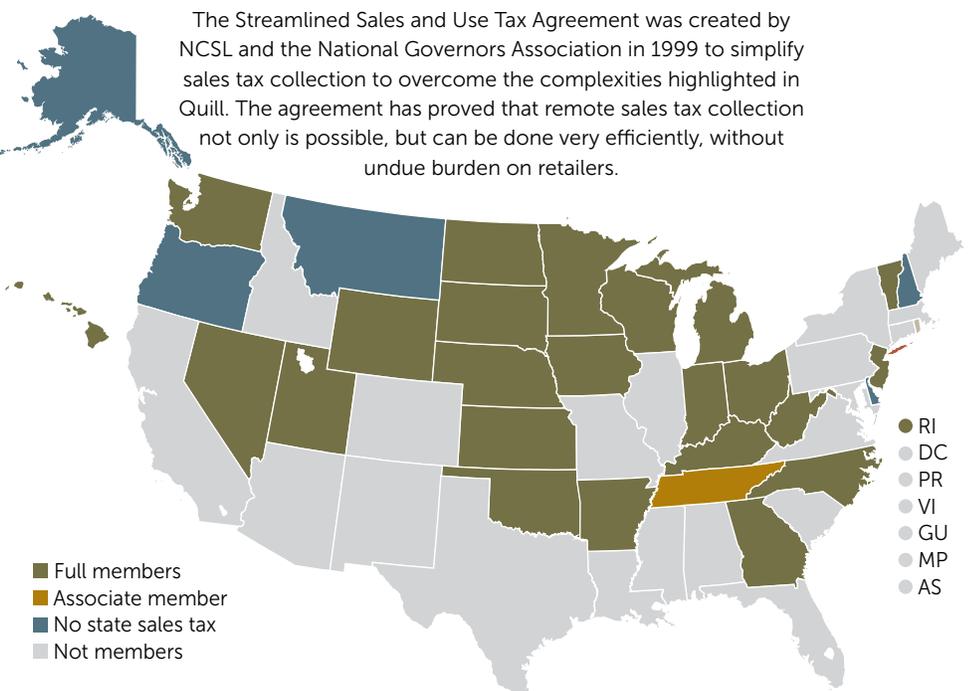
When NCSL President and South Dakota Senator Deb Peters (R) introduced legislation in 2016, her intent was clear: force a legal challenge in the hopes of ultimately overturning *Quill*.

“State sovereignty, or states’ rights, is not a doctrine of convenience,” Peters said. “Rather, it’s the idea that states, and their citizens, know best how to govern themselves.”

Peters’ legislation requires out-of-state sellers to collect and remit the state’s sales tax based on their volume of sales in the state, rather than their physical presence in the state. Businesses included are those that either sell more than \$100,000 in goods, or process 200 or more transactions annually in South Dakota, or both.

### Keep It Simple

The Streamlined Sales and Use Tax Agreement was created by NCSL and the National Governors Association in 1999 to simplify sales tax collection to overcome the complexities highlighted in *Quill*. The agreement has proved that remote sales tax collection not only is possible, but can be done very efficiently, without undue burden on retailers.



Source: NCSL



*South Dakota Senator, and NCSL president, Deb Peters testifying before a congressional subcommittee on behalf of states.*

Before the law became effective, the state sent letters to more than 200 online retailers to let them know they would need to start collecting and remitting sales taxes or risk legal action. Only 70 remote sellers complied. The state responded by filing a complaint in court against the defiant retailers.

### **On the Fast Track**

Designed to elicit legal action, the law states that if its legality is challenged, the case must be heard “as expeditiously as possible” by a state circuit court.

Appeals to circuit court rulings in South Dakota go directly to the state Supreme Court, which, the law states, must also hear the case as expeditiously as possible.

These provisions are why, in less than

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two years from enactment, the law has made it to the U.S. Supreme Court.

The defendants—Wayfair.com, Overstock.com and Newegg.com—have argued the law is unconstitutional because it violates the *Quill* decision. The state has countered that *Quill* is no longer relevant considering how much has changed since the case was decided 25 years ago.

The circuit court agreed with the online retailers and, ultimately, the state Supreme Court did too. In October 2017, the state formally petitioned the U.S. Supreme

Court, asking for the authority to enforce its 2016 remote sales tax law.

In January, the Supreme Court agreed to hear the case, and in February, set April 17 for oral arguments.

### **Better Late Than Never**

Regardless whether the Supreme Court hears the case or Congress passes legislation that negates the case, it will have a profound effect on states and the future of the sales tax.

Although it’s too late to benefit Wayne Kodey, the former camera store owner, there are plenty of other Main Street retailers who could be breathing a little easier if Congress or the high court agrees that remote sellers should be collecting the same state sales taxes they are required to collect. And that will make all the work state lawmakers and NCSL staff put into this effort well worth it. 