



Southeast Association of Tax Administrators

Constitutional Issues with Some States' Recently Enacted Sales/Use Tax Remitting and Reporting Requirements

July 12, 2010

**Presented By: Carolynn S. Iafrate
Fred Nicely**

U.S. Supreme Court Refresher

► Substantial Nexus

- *Miller Bros. v. Maryland*, 347 U.S. 340 (1954)
 - Court rejects Maryland’s attempt to require Delaware retailer to collect tax based on 1) radio advertising, 2) mailed circulars, 3) use of common carriers and 4) delivery of goods in retailer’s vehicles.
- *Nat’l Bellas Hess v. Dept. of Revenue*, 386 U.S. 753 (1967)
 - Illinois provision requiring remote sellers soliciting sales in the state via advertising and catalogs struck down – a retailer’s use of common carriers and U.S. mail is not enough to create collection responsibility.
- *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)
 - Court separates “Due Process nexus” from “substantial nexus” requirement under the Commerce Clause – Court notes the complexity in collecting the tax for over 6,000 taxing jurisdictions and Congress has authority to address this issue – Court reaffirms *Bellas Hess*’ physical presence requirement.

U.S. Supreme Court Refresher

► Agency Relationships

- *Scripto v. Carlson*, 362 U.S. 207 (1960)
 - Court affirms Florida’s assessment of a Georgia entity – Court focused on the concern with “contractual shifts” being made from salesmen employed by a business to just being hired as independent contractors. Court noted this “would open the gates to a stampede of tax avoidance.” Court specifically distinguishes *Miller Bros.* by noting *Miller Bros.* did not have any solicitors located in the taxing state (MD).
- *Tyler Pipe Ind. v. Washington State*, 483 U.S. 232 (1987)
 - Not addressing a sales/use tax, but Washington’s gross receipts tax (B&O tax), the Court first held that a local manufacturing exemption discriminated against interstate commerce. Next, the Court affirmed Tyler Pipe’s sales representatives status as independent contractors created sufficient nexus because “[they] perform any local activities necessary for maintenance of Tyler Pipe's market...”

U.S. Supreme Court Refresher

▶ Regulating Interstate Commerce

- *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935)
 - Court held New York could not regulate price paid to milk producers in other states. The Court stated “It is the established doctrine of this court that a state may not, in any form or under any guise, directly burden the prosecution of interstate business.” The Court also stated: “[The Constitution] was framed upon the theory that the peoples of the several states must sink or swim together, and that, in the long run, prosperity and salvation are in union and not division.”
- *Pike v. Bruce Church*, 397 U.S. 137 (1970)
 - Court strikes down Arizona law that effectively would have required a cantaloupe grower in Arizona to open or use a packaging facility in Arizona and not California – Court holds that legitimate regulation of local public interest will only be upheld if: 1) the effects on interstate commerce are only incidental and 2) the burden imposed on such commerce is not clearly excessive in relation to the putative local benefits. Court did not find a compelling state interest to uphold the regulation.

Spreading the News: Click-Through Nexus

- ▶ ***Amazon.com / Overstock.com*, N.Y.S. 2d, 2009 WL 69336 (Jan. 12, 2009)**
- ▶ **New York was the first state to pass legislation creating a presumption that sales by out-of-state retailers were taxable as a result of participating in an affiliate program where:**
 - Remote seller enters into an agreement with a NY resident whereby the NY resident directly or indirectly refers NY customers to a remote seller by an Internet link in exchange for a commission; and
 - Remote seller's cumulative gross receipts to NY customers, from NY resident's referral, exceeds \$10K during preceding four quarters
- ▶ **Presumption is rebuttable:**
 - Remote seller establishes that only activity performed by NY resident is a link, and none of NY resident's representatives solicit sales for remote seller
 - Remote seller must establish both prohibition against such activities and compliance with the prohibition

Spreading the News: Click-Through Nexus

► Other States' Reactions

- Similar legislation enacted in NC and RI in 2009
- Legislation vetoed in CA and HI in 2009
- Other states that have considered or are considering such legislation in 2010 include: CA, CO, CT, FL, IA, IL, MD, MN, MS, NM, OK, TN, TX, VA, VT, and WI
- CO legislation amended to remove click-through, but enacted onerous reporting requirements for out-of-state vendors and commonly-controlled group affiliate nexus
- CA and TN considering legislation modeled after CO commonly-controlled group affiliate nexus and reporting requirements
- RI proposal to repeal 2009 enactment

Overview of Colorado HB 1193

▶ **STATUTORY REQUIREMENTS IMPOSED ON OUT-OF-STATE RETAILERS**

- Provide purchaser with notice at time of sale about use tax reporting and payment obligations;
- File an annual report with the State for each Colorado purchaser disclosing each purchaser's total dollar amount during the previous calendar year; and
- Provide annual notification, in writing, to each Colorado purchaser (via 1st class mail) stating that Colorado requires the purchaser to file a sales/use tax return and pay any tax due, and list for each purchase, the relevant dates, amounts, and category of the purchase.

Overview of Colorado HB 1193

- ▶ **SIGNIFICANT PENALTIES FOR NONCOMPLIANCE**
- ▶ **If non-collecting retailer fails to meet reporting and notification requirements, retailer is subject to significant penalties:**
 - \$5 for each failure to provide required notification at time of purchase;
 - \$10 for each failure to provide required annual purchaser notification and report; and
 - \$10 for each failure to file individual annual purchaser report with State.
- ▶ **How are those penalties collected – civil action or tax assessment?**

Similar “Copycat” Legislation

- ▶ **Other jurisdictions likely to enact a version of HB 1193:**
- ▶ **Oklahoma recently enacted legislation (HB 2359)**
- ▶ **Considered in Tennessee (SB 1741/HB 1947) and still pending in California (AB 2078)**
- ▶ **Approximately 284 local Colorado jurisdictions, with different use tax laws, will those local jurisdictions in Colorado enact their own version of State notice and reporting requirements?**
- ▶ **Colorado and Oklahoma claim they will allow the use of generic notification statements as other states impose their notification requirements – how will that be done when the notices require specific references to the state tax agency’s website?**

Oklahoma's Legislation (HB 2359)

- ▶ **Unlike Colorado, Oklahoma's law only requires two notices:**
 - Notice is required on the Internet site or catalog, as applicable
 - Notice is also required on the invoice
- ▶ **It also requires tax preparers at the time of preparing a taxpayer's income tax return to advise their clients of the use tax responsibility**
- ▶ **On the positive side, the law does offer some incentives. It offers another amnesty to remote sellers that agree to collect Oklahoma's sales/use tax for three years and provides up to \$500 reimbursement for new remote sellers signing up to use a certified service provider to collect Oklahoma's tax**

Click-Through Nexus Litigation

▶ New York

- Amazon.com and Overstock.com have challenged New York's legislation on grounds that their activities in the state did not create nexus under the Dormant Commerce Clause and that the affiliate program was simply advertising
- Court dismissed taxpayer's complaint and granted NY's motion for summary judgment; matter on appeal – oral argument heard Nov. 2, 2009

Click-Through Nexus Litigation

▶ Amazon v. North Carolina DOR

- Amazon.com LLC filed a federal lawsuit alleging the North Carolina Dep't of Revenue's attempts to obtain names, address, and purchases of customers violates the First Amendment of the US Constitution, Article I, §§ 4, 5 of the Washington State Constitution, and federal Video Privacy Protection Act, 18 USC § 2710
- Suit filed on April 19 in federal district court in the Western District of Washington
- Declaratory judgment sought to confirm above federal and state constitutional violations and federal statutory violation
- American Civil Liberties Association (ACLU) also filing suit

Colorado Forced Notification Litigation

▶ Direct Marketing Association filed suit 6/30/2010

- Violates Commerce Clause
 - Notice and reporting requirements are tantamount to the use tax collection burden found unconstitutional in *Quill* absent physical presence of retailer;
 - Overbroad notice and reporting requirements impose excessive burdens on interstate commerce in relation to the local benefits;
 - Application only to out-of-state retailers facially discriminates against interstate commerce (and is not a compensatory tax);
 - Legislative intent was protectionist.
- Violates First Amendment
 - Compels retailers to engage in commercial speech.

Federal Streamlined Legislation

- ▶ **Main Street Fairness Act finally introduced July 1, 2010 by Rep. Delahunt (MA) – HR 5660**
 - Placeholders for controversial issues – vendors compensation and communications services tax simplification
 - Are states' attempts to circumvent Quill through click-through nexus and reporting requirements undermining SST effort?
 - Should states efforts to continue such circumvention be addressed in the MSFA?



Questions?

Contact Information

▶ **Carolynn S. Iafrate**

- (610) 458-7227
- csiafrate@industriysalestax.com

▶ **Fred Nicely**

- (202) 484-5213
- fnicely@cost.org