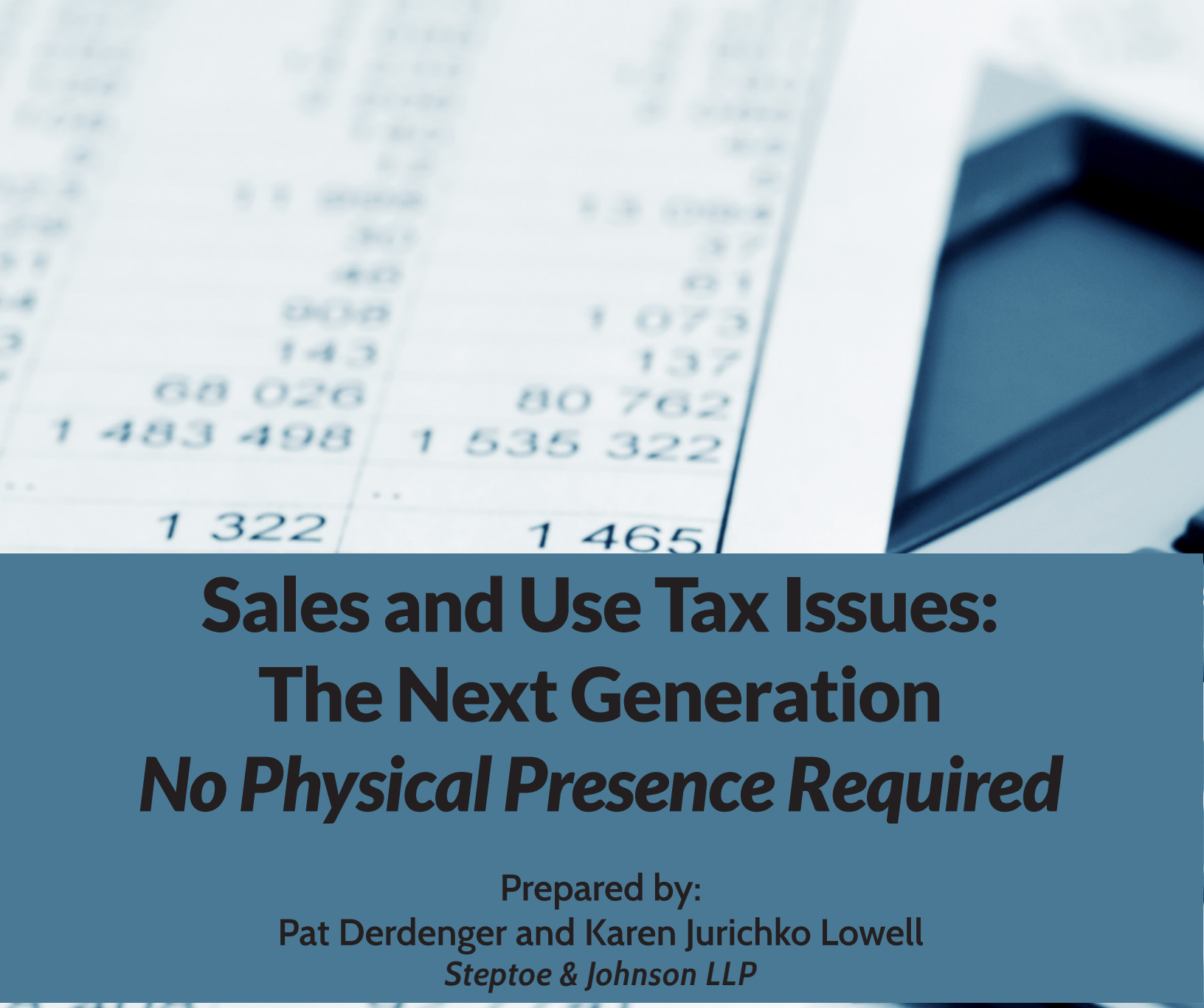

Sales and Use Tax Issues: The Next Generation *No Physical Presence Required*

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Published on www.lorman.com - January 2019

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1. *THE NEXT GENERATION – NO PHYSICAL PRESENCE REQUIRED.*

Invigorated by Justice Kennedy's concurrence in *Direct Marketing Association,* states are opting to enact legislation that does not even purport to satisfy *Quill's* physical presence requirement. While click-through, agency, and even distribution center nexus provisions at least purport to be based on concepts derived from *Quill*, several jurisdictions have adopted or are considering legislation that simply makes remote vendors taxable regardless of nexus. States legislatures have enacted a spate of laws specifically designed to test the limits of *Quill* and Justice's Kennedy's call for litigation.

5.1 Notice and Reporting Requirements

A. History of Notice and Reporting Requirements: the *Direct Marketing Association* Case.

In 2010, the Colorado Legislature adopted H.B. 1193, which created some fairly stringent information reporting, notice requirements and penalties for remote vendors that *do not have nexus with Colorado.* Under the bill, remote vendors are required to:

- Notify purchasers that use tax is due on purchases from the remote vendor and that the State requires the purchaser to file a use tax return. There is a penalty of $5 per each failure to provide this notice absent reasonable cause.
- Provide each Colorado purchaser, by January 31st of the following year, with a report that informs the purchaser of the total amount paid to the remote vendor during the previous calendar year, the dates of the purchases, the amount of each purchase and the item purchased. H.B. 1193 requires the remote vendor to send a similar report for each purchaser to the Colorado Department of Revenue. H.B. 1193 imposes a $10 penalty per report for each failure absent reasonable cause.

Remote vendors challenged the notice and reporting requirements in H.B. 1193 in federal court, and on January 26, 2011 the judge issued a preliminary injunction preventing the notification and reporting requirements from going into effect pending resolution of the case. *See Direct Marketing Association v.*

Huber, 2011 WL 250556 (D. Colo. 2011). The judge issued the preliminary injunction because the plaintiffs demonstrated a substantial likelihood of prevailing on their claims that the law violated the Commerce Clause, especially in light of *Quill's* physical presence safe harbor. The Colorado Department of Revenue initially appealed the injunction to the 10th Circuit Court of Appeals, but withdrew the appeal. Motions for summary judgment on the merits of the case were filed with the District Court in May, 2011.

On March 30, 2012, the District Court permanently enjoined the Colorado Department of Revenue from enforcing H.B. 1193. The court held that the requirements violated the U.S. Commerce Clause for two reasons: (1) they discriminate against interstate commerce by facially placing burdens on out-of-state vendors that are not also borne by in state vendors and because Colorado has reasonable alternatives available for enforcing use tax collection; and (2) they place undue burdens on interstate commerce and violate *Quill's* physical presence requirement. While the court noted that the notice and reporting requirements are not actual taxes, it viewed those requirements as something akin to use tax collection because their sole purpose is to enhance use tax collection by the State.

The US Court of Appeals for the 10th Circuit then lifted that injunction on August 20, 2013. It determined that the District Court did not have authority to hear the case and issue the injunction because of the federal Tax Injunction Act (TIA), 28 U.S.C. § 1341. The TIA prohibits federal courts from enjoining, suspending or restraining the collection of any state taxes as long as state courts can provide a speedy and efficient remedy. The 10th Circuit reasoned that the injunction restrained use tax collection and that state courts provided adequate redress channels. *Direct Mktg. Ass'n v. Brohl*, 735 F.3d 904 (10th Cir. 2013).

The case was appealed to the US Supreme Court. In 2015, the Supreme Court reversed the 10th Circuit, holding that enforcement of Colorado's notice and reporting requirements was not an "assessment, levy, or collection" within scope of Tax Injunction Act, and that an injunction against enforcement of notice and reporting requirements would not "restrain" the assessment, levy, or collection of tax under the act. *Direct Marketing Ass'n. v. Brohl*, 575 U.S. 1124, 135 S.Ct. 1124 (2015). The Supreme Court remanded the case back to the 10th Circuit for a consideration of the merits of the notice and reporting requirements.

Perhaps more notable, however, was Justice Anthony Kennedy's concurring opinion, in which he decried the "continuing injustice" and "extreme harm and unfairness" faced by states because of *National Bellas Hess* and *Quill*. Justice Kennedy also urged the legal community to find an appropriate case for the Court to reevaluate *National Bellas Hess* and *Quill*.

On remand, 10th Circuit issued its decision on February 22, 2016. *Direct Marketing Ass'n. v. Brohl*, 814 F.3d 1129 (10th Cir. 2016). The court reversed the district court, holding that Colorado's notice and reporting obligations for remote retailers do not discriminate against or unduly burden interstate commerce, and therefore do not violate the dormant Commerce Clause. According to the 10th Circuit, *Quill* applies narrowly to sales and use tax collection but does not forbid states from imposing regulatory requirements on retailers that lack nexus with the state. The US Supreme Court denied further review in *Brohl v. Direct Marketing Association*, 137 S.Ct. 593 (Dec. 12, 2016)

B. Notice and Reporting Requirements in Other States

Following Colorado's passage of H.B. 1193, Kentucky, Oklahoma, South Dakota, and Vermont have passed laws with similar reporting requirements. Vermont's click-through nexus law also places reporting requirements on remote vendors that do not have nexus. In the wake of *Direct Marketing Association*, an additional number of states have opted to adopt notice and reporting legislation.

The Oklahoma bill (H.B. 2359, 2010, amending 68 Okla. St. Ann. § 205.1), for example, creates a presumption of nexus based on affiliation and also requires remote vendors to notify purchasers on their websites, in catalogs or on invoices that use tax is due. In addition, Oklahoma has adopted a regulation to effectuate this provision. Okla. Admin. Code 710:65-21-8. Pursuant to the regulation, remote vendors whose gross sales into Oklahoma for the prior year exceed $100,000 must give notice on their web-sites, catalogs, or invoices that use tax is due on all non-exempt purchases and should be paid by the purchaser. The notice must state: (1) the remote vendor is not required to, and does not, collect sales or use tax; (2) the purchase is subject to use tax unless otherwise exempt; (3) the purchase is not exempt simply because it was made from a remote vendor; (4) the purchaser must remit use tax to the state; and (5) forms for reporting are available on the Oklahoma Tax Commission's website. Okla. Admin. Code 710:65-21-8.

In 2016, Oklahoma added to its notice law, requiring that vendors send a statement to customers by February 1 of each year which contains the following language:

> You may owe Oklahoma use tax on purchases you made from us during the previous tax year. The amount of tax you may owe is based on the total sales price of [insert total sales price] that must be reported and paid when you file your Oklahoma income tax return unless you have already paid the tax.

Oklahoma H.B. 2531 (2016). The new law took effect on November 1, 2016.

Notice and reporting requirement legislation has flourished in months following the 10th Circuit's 2016 decision in *Direct Marketing Association*. The following states have adopted legislation imposing notice and reporting requirements.

State	Law	Effective Date
Alabama	Ala. Code § 40-2-11(7)(b)	7/1/2017
Colorado	Colo. Rev. Stat. Ann. § 39-21-112(3.5)(c)(I)	7/1/2017[1]
Kentucky	Ky. Rev. Stat. § 139.450	7/1/2013
Louisiana	LSA-R.S. § 47:309.1	7/1/2017
Oklahoma	68 Okla. St. Ann. § 205.1 68 Okla. St. Ann. § 1406.2	6/9/2010 11/1/2016
Rhode Island	R.I. Gen. Laws § 44-70-1 *et seq.*	8/7/2017
South Dakota	S. Dak. Cod. Laws § 10-63-1 *et seq.*	7/1/2011
Tennessee	Tenn. Code Ann. § 67-6-515(f)(1)(A)	3/26/2012
Vermont	32 Vt. Stat. Ann. § 971	5/24/2011

[1] Following the extensive *Direct Marketing Association* litigation, Colorado's notice and reporting requirements finally took effect on July 1, 2017, despite being enacted in 2011.

State	Law	Effective Date
		7/1/2017
Washington	Wash. Rev. Code Ann. § 82.001.002	1/1/2018

5.2 Economic Nexus.

The first state to take action was Alabama. In October 2015, its Department of Revenue adopted a controversial economic nexus regulation targeting out-of-state retailers with substantial sales in the state. Regulation 810-6-2-.90.03, which took effect January 1, 2016, establishes economic nexus for out-of-state sellers lacking an Alabama physical presence if they make retail sales of tangible personal property into the state exceeding $250,000 and conduct certain additional activities in the state. After the draft regulations were first released in the summer of 2015, the state's Governor, Robert Bentley, urged Amazon or another online retailer to sue Alabama in order to get the issue before the U.S. Supreme Court. David Sawyer, *Alabama Governor to Amazon: Sue Us*, State Tax Notes, 2015 STT 150-1 (Aug. 5, 2015).

A similar law followed in South Dakota. The governor signed S.B. 106 into law on March 22, 2016. The law established that out-of-state sellers have nexus if their gross revenue from sales into the state in the prior year exceeds $100,000 or 200 unique transactions. Enforcement of the law is stayed, however, pending a binding court judgment establishing the constitutionality of the law. South Dakota's legislation is particularly aimed at bringing the principles of *Quill* back before the Supreme Court: the S.B. 106 itself states "Given the urgent need for the Supreme Court of the United States to reconsider this doctrine, it is necessary for this state to pass this law clarifying its immediate intent to require collection of sales taxes by remote sellers, and permitting the most expeditious possible review of the constitutionality of this law." S.B. 106, Section 8(8). Although enforcement is stayed, the law allows South Dakota to bring a declaratory judgment action against a taxpayer to whom it believes the law applies, even without auditing that taxpayer. Any appeal of the declaratory judgment action must be made directly to the South Dakota Supreme Court and be heard "as expeditiously as possible." For a detailed discussion of the pending legislation regarding S.B. 106, see the section for South Dakota in Section 6, Recent Nexus Developments, below.

A number of states jumped on the economic nexus bandwagon during the 2017 legislative session, although none of these states are currently enforcing its economic nexus provisions. Rather, the laws feature delayed effective dates pending a US Supreme Court decision overruling *Quill* or congressional action permitting states to impose taxes on remote sellers or are otherwise stayed pending the outcome of litigation involving the statute.

The chart below summarizes the states that have adopted economic nexus provisions. Specifics regarding each state's law and its enforcement status can be found in Section 6, Recent Nexus Developments, below.

State	Law	Effective Date	Status
Alabama	Ala. Dep't of Revenue Rule 810-6-2-.90.03	1/1/2016	Enforcement delayed pending litigation
Indiana	Ind. Code § 6-2.5-2-1	7/1/2017	Enforcement delayed pending litigation
Maine	36 M.R.S.A. §1951-B	10/1/2017	
Maryland	H.B. 1213 (2017)	Proposed	
Massachusetts	Mass. Dep't of Revenue Directive 17-1	10/1/2017	Revoked 6/28/2017 by Directive 17-2 pending legislative action
North Carolina	S.B. 81 (2017)	Passed Senate	Referred to House Committee on Finance
North Dakota	N. Dak. Cen. Code Ann. § 57-39.2-02.2	4/7/2017	Effective pending change to *Quill* or congressional action
Oklahoma	S.B. 1251 (2016)	Failed	
Rhode Island	R.I. Gen. Laws § 44-70-1 *et seq.*	8/7/2017	
Pennsylvania	72 P.S. § 7213	10/30/2017	
South Dakota	S. Dak. Cod. Laws § 10-64-1 *et seq.*	5/1/2016	Enforcement delayed pending litigation
Tennessee	Tenn. Dep't of Revenue	6/16/2016	Enforcement delayed

State	Law	Effective Date	Status
	Rules 1320-05-01-.63 and 1320-05-01-.129		pending litigation
Vermont	32 V.S.A. § 9712	5/25/2016	Effective pending change to *Quill* or congressional action
Washington	Rev. Code Wash. § RCW 82.08.053	1/1/2018	
Wyoming	Wyo. Stat. Ann § W.S. 39-15-501	7/1/2017	Enforcement delayed pending litigation

State proposals to establish economic nexus continued to proliferate in the legislative session following the Supreme Court's grant of certiorari in *Wayfair*. The following states are considering economic nexus legislation (all bills are pending as of this update—March 2018):

State	Bill
Georgia	H.B. 61
Hawaii	S.B. 2508; S.B. 2514
Idaho	H. 0578
Iowa	H.F. 2046
Kansas	H.B. 2756
Nebraska	L.B. 44 (A.M. 1822); L.B. 1088

Not all attempts to circumvent *Quill* postdate *Direct Marketing Association*. In 2011, the District of Columbia enacted the Budget Request Act of 2011. That act requires all remote vendors that sell tangible personal property or taxable services to District residents over the internet to collect and remit sales tax regardless of nexus or physical presence. However, before the act can become effective, the District has to enact multiple ordinances, including ordinances to: (1) create a remote vendor registry; (2) establish protection for consumer privacy; (3) delineate the specific products and services that will be taxable and exempt; and (4) create a small internet vendor exemption. Additionally, in 2014 the District of Colombia passed legislation that requires remote vendors to collect sales tax on sales made over the internet, regardless of nexus in the District; however, this law only takes effect 120 days after effective date of the

Marketplace Fairness Act of 2013 (which to date has not passed). DC ST § § 47-3931 to -3934 (2014).

In 2013, both houses of the New Mexico Legislature passed a bill which would have amended the definition of "engaged in business" within the state to include a remote vendor selling goods that are delivered, directly or indirectly, to New Mexico customers. Senate Bill 539, was introduced in February 2013 and passed by both houses in March 2013, but governor failed to sign it.

Oklahoma introduced legislation that would amend the definition of taxable "sales" to include all sales made over the internet and delivered to Oklahoma purchasers, regardless of whether the remote vendor has nexus. The bill would exempt out-of-state internet vendors only if they are located in a state that exempt sales made into it by Oklahoma vendors. H.B. 1337 (2013).

Finally, Utah enacted an incentive bill, H.B. 300, in 2013. The bill, which was signed into law on March 22, 2013, is a back-stop provision designed to encourage remote vendors to voluntarily collect sales tax if the U.S. Supreme Court or Congress does not issue a decision or enact legislation to overrule *Quill*. It allows remote vendors that are not required to pay Utah sales tax under *Quill* to take an 18% collection allowance if the remote vendor voluntarily registers (for the first time) and begins collecting and remitting sales tax to the State after January 1, 2014. If a remote vendor takes this collection allowance, it is not entitled to retain any other collection allowance and the State Tax Commission may require electronic return filing. If the U.S Supreme Court or Congress authorizes collection from remote vendors, remote sellers would not be able to take the collection allowance because collection would no longer be voluntary.

5.3 Tracking Cookie Nexus.

Another recent development broadening the concept of nexus is the adoption of tracking cookie nexus laws. Under these laws, an online retailer is deemed to have nexus with a state if sales to in-state customers exceed a certain threshold and the retailer uses information or software, including cached files, cached software, "cookies," or other data tracking tools, that are stored on customers' computers in the state. The theory is that software or data files stored on the customer's computer constitute a physical presence in the state sufficient to establish nexus.

At present, three states have adopted laws or rules finding nexus based on the in-state presence of tracking cookies.

State	Law	Effective Date
Ohio	Oh. Rev. Code. Ann. § 5741.01 (I)(2)(h)	1/1/2018
Massachusetts	830 CMR 64H.1.7	10/1/2017
Rhode Island	R.I. Gen. Laws § 44-70-1 *et seq.*	8/7/2017

5.4 Marketplace Nexus

The latest trend among states seeking to expand their tax bases is to impose nexus on online marketplaces. Under these laws, an online marketplace providing e-commerce infrastructure, customer service, payment processing services, and marketing, may be required to register and collect tax as the retailer, rather than the individual sellers who are making the sales. Some states also impose reporting requirements on the marketplace facilitator.

The following states have adopted marketplace nexus laws or rules:

State	Law	Effective Date
Arizona	Ariz. Dep't of Revenue TPR 16-3	9/20/2016
Minnesota	Minn. Stat. § 297A.66	Earlier of a modification to *Quill* or 7/1/2019
Pennsylvania	72 P.S. § 7213	10/30/2017
Rhode Island	R.I. Gen. Laws § 44-70-1 *et seq.*	8/7/2017
Washington	Rev. Code Wash. § RCW 82.08.053	1/1/2018