

Alert | State & Local Tax (SALT)



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Sales Tax Ripples from the Keystone State to the Golden State – Impact of Pennsylvania’s *Online Merchants Guild* Decision on California Sales Tax

The Commonwealth Court of Pennsylvania recently held in *Online Merchants Guild v. Hassell*¹ that the Pennsylvania Department of Revenue failed to provide sufficient evidence that non-Pennsylvania businesses selling merchandise through third-party online fulfillment services (“Fulfillment Services”) had sufficient contacts with Pennsylvania such that the Department could mandate out-of-state businesses to collect and remit sales tax.² The court highlighted that the non-Pennsylvania businesses’ connections to Pennsylvania were limited to the storage of merchandise by these Fulfillment Services in their Pennsylvania warehouses.

1. The Due Process Clause Seizes the Day in Pennsylvania.

In *Online Merchants Guild*, the Department sent questionnaires to Online Merchants Guild members suggesting they “may have” a physical presence in Pennsylvania that would require the collection and remittance of Pennsylvania sales tax. The Department asserted that storing inventory at a distribution or fulfillment center in Pennsylvania constituted a physical presence that created sales-tax nexus.

¹ 2022 Pa. Commw. LEXIS 119 (Commw. Ct. Sep. 9, 2022).

² The court also applied the same rationale to Pennsylvania’s personal income tax.

The Guild argued that the Department failed to establish that Guild members had sufficient minimum contacts with Pennsylvania under the U.S. Constitution's Due Process Clause because Fulfillment Services, rather than Guild members, controlled the storage and shipment of goods.

The court disagreed with the Department's position on several grounds. Importantly, the court held that the Due Process Clause requires (1) a connection between a taxing authority and an entity or person it seeks to tax and (2) some act indicating the alleged taxpayer has availed itself of the taxing authority's protections, opportunities, and services.

As a result, the court found that because the Fulfillment Services determined the storage location of goods shipped to them by Guild members, the members did not have control as to whether the goods would remain in Pennsylvania or be purchased by customers located in the state.

2. From the Keystone State to the Golden State. Is California Next?

Until California's enactment of the Marketplace Facilitator Act (Act) (effective Oct. 1, 2019),³ similar to the Pennsylvania Department of Revenue, the California Department of Tax and Fee Administration (CDTFA) adopted the position that an out-of-state seller with no connections to California other than the storage of merchandise in a Fulfillment Services' California warehouses is doing business in California, and thus, is required to collect and remit sales tax on sales delivered to California customers. While the Act forecloses this position on a prospective basis, CDTFA continues to enforce its position with respect to tax periods beginning prior to Oct. 1, 2019.

CDTFA's position, however, is vulnerable to attack on the same grounds upon which the Pennsylvania court struck down the similar position of the Pennsylvania Department of Revenue. Although the *Online Merchants Guild* decision is limited to the Pennsylvania sales tax, the court's federal Due Process Clause analysis may similarly apply to hold that non-California Fulfillment Services sellers with in-state connections limited to the storage of merchandise in in-state Fulfillment Services' warehouses lack sufficient contact with California to be held responsible for collecting and remitting California sales tax.

In fact, in 2020, the Guild filed a lawsuit in federal court, *Online Merchants Guild v. Maduros*,⁴ similarly challenging CDTFA's position with respect to non-California Fulfillment Services sellers, based on the grounds, among others, that it violates the Due Process Clause. In 2021, the U.S. District Court for the Eastern District of California dismissed the case, finding it barred under the Tax Injunction Act, which mandates most state tax cases to be heard in state courts. The Guild appealed that decision to the Ninth Circuit Court of Appeals. The Ninth Circuit recently heard oral argument, and the case is now pending the court's decision.

3. Considerations for Affected Non-California Fulfillment Services Sellers

With CDTFA's continued enforcement of its position, some non-California Fulfillment Services sellers, with no connections to the state other than the storage of merchandise in in-state warehouses, that sold merchandise to California customers prior to Oct. 1, 2019, continue to remain under audit or have been assessed by the CDTFA. Fulfillment Services sellers that have not yet been contacted by the CDTFA generally remain vulnerable to audit and assessment of tax, interest, and penalties for sales made to California customers prior to Oct. 1, 2019. However, with the *Online Merchants Guild* decision, the

³ The Marketplace Facilitator Act, added by AB 147 (Stats. 2019, ch. 5), and amended by SB 92 (Stats. 2019, ch. 34) and AB 1402 (Stats. 2021, ch. 421), in relevant part, provides that beginning Oct. 1, 2019, a marketplace facilitator is generally responsible for collecting, reporting, and paying the tax on retail sales made through their marketplace for delivery to California customers.

⁴ E.D. Cal. Case No. 2:20-cv-01952-MCE-DB, 9th Cir. Case No. 21-16911.

pending *Maduros* case, and other potential challenges to CDTFA's position, the viability of CDTFA's position remains uncertain.

Affected Fulfillment Services sellers should consider filing claims for refund for any California sales tax already paid to the CDTFA as soon as possible, as the deadline to file such claims may be expiring soon for some Fulfillment Services sellers. Similarly, Fulfillment Services sellers that are under audit or have been assessed, but not yet paid, should consider availing themselves of administrative remedies to defend against audits and oppose assessments.

Authors

This GT Alert was prepared by:

- [Bradley R. Marsh](#) | +1 415.655.1252 | Bradley.Marsh@gtlaw.com
- [Shail P. Shah](#) | +1 415.655.1300 | Shail.Shah@gtlaw.com
- [Ruben Sislyan](#) | +1 310.586.7765 | sislyanr@gtlaw.com

** Special thanks to James T. Smith for his valuable contributions to this GT Alert.*

Additional Greenberg Traurig's State and Local Tax Team Members:

- [Lawrence H. Brenman](#) | +1 312.456.8437 | brenmanl@gtlaw.com
- [G. Michelle Ferreira](#) | +1 415.655.1305 | ferreiram@gtlaw.com
- [Scott E. Fink](#) | +1 212.801.6955 | finks@gtlaw.com
- [Colin W. Fraser](#) | +1 949.732.6663 | frasercw@gtlaw.com
- [Brian Gaudet](#) ‡ | +1 617.310.6000 | gaudetb@gtlaw.com
- [Courtney A. Hopley](#) | +1 415.655.1314 | hopleyc@gtlaw.com
- [Barbara T. Kaplan](#) | +1 212.801.9250 | kaplanb@gtlaw.com
- [Marvin A. Kirsner](#) | +1 954.768.8224 | kirsnerm@gtlaw.com
- [Ivy J. Lapidés](#) | +1 212.801.9208 | lapidesi@gtlaw.com
- [Martin L. Lepelstat](#) | +1 973.443.3501 | lepelstatm@gtlaw.com
- [Jonathan I. Lessner](#) | +1 302.661.7363 | lessnerj@gtlaw.com
- [Natalie Mackary](#) | +1 949.732.6540 | mackaryn@gtlaw.com
- [Joel D. Maser](#) | +1 954.765.0500 | maserj@gtlaw.com
- [Richard J. Melnick](#) | +1 703.903.7505 | melnickr@gtlaw.com
- [Marc J. Musyl](#) | +1 303.572.6585 | musylm@gtlaw.com
- [Glenn Newman](#) | +1 212.801.3190 | newmang@gtlaw.com
- [Neil Oberfeld](#) | +1 303.685.7414 | oberfeldn@gtlaw.com
- [Cris K. O'Neill](#) | +1 949.732.6610 | oneallc@gtlaw.com

- Shira Peleg | +1 212.801.6754 | pelegs@gtlaw.com
- Josh Prywes | +1 214.665.3626 | prywesj@gtlaw.com
- James P. Redding ‡ | +1 617.310.6061 | reddingj@gtlaw.com
- Andrew P. Rubin | +1 303.572.6552 | rubina@gtlaw.com
- Jake B. Smith | +1 602.445.8334 | smithjake@gtlaw.com
- Jennifer A. Vincent | +1 415.655.1249 | vincentj@gtlaw.com

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