

Economic Nexus

States Eye Expanding Scope of Their Taxing Jurisdiction

Over the last few years, numerous states have enacted laws or regulations that test the limits of their authority to require out of state retailers to collect and remit sales and use tax. Some states have also sought to require online retailers to provide information to assist the states with collecting sales and use tax from the purchasers. Online retailers should track recent developments regarding state sales and use tax collection and information reporting requirements to stay up to date on their compliance obligations.

States typically impose sales and use tax on sales of tangible personal property—unless a specific exemption applies—and also impose tax on certain enumerated services. While sales and use taxes are often referred to collectively, they are two related, but separate, taxes.

Sales taxes are generally imposed on taxable sales made within a state and do not apply to out of state sales, such as online purchases. For such purchases shipped from out of state, however, use tax generally applies where the purchaser will receive or use the items within the state.

Nexus Defined

While use tax is imposed on the purchaser, if the seller has sufficient contacts with the purchaser's state—known as “nexus”—then the state has the authority to require the out of state retailer to collect and remit the use tax.

If the seller does not have nexus, then the state lacks the jurisdiction to require the seller to collect and remit the use tax, and the purchaser is responsible for reporting and remitting his or her own use tax. Since many purchasers do not comply with requirements to remit the tax, and state tax department enforcement of such obligation for small purchases by many individuals is expensive and impractical, many states are seeking to assert nexus to the extent of the constitutional limitations on their taxing authority and to test the boundaries of such power.

Generally, a retailer has nexus with a state if it has a physical presence, such as employees



or property, within the state. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U.S. Supreme Court provided this physical presence standard, and since that time, states have increasingly asserted this physical presence standard to include the activities of third parties, such as agents, independent contractors and affiliates, acting within the state on a retailer's behalf.

Information Reporting and Notification Requirements

In 2010, Colorado enacted a sales and use tax information reporting, or notification, requirement. Under the law, certain out of state sellers that do not have sales and use tax nexus with Colorado are still subject to information reporting requirements. Further, out of state sellers must send notices to their Colorado customers informing them of their requirement to pay the use tax on their purchases; send an annual report with

purchase details to customers spending more than \$500 with the retailer during the year; and if the retailer made annual sales of \$100,000 or more in Colorado, file a report with the Colorado Department of Revenue informing the tax department about the customers' names and total purchases.

In litigation that continued for several years, the Direct Marketing Association argued that the information reporting law was unconstitutional, yet on Feb. 22, 2016, the Tenth Circuit Court of Appeals upheld the Colorado law as constitutional. [See *Direct Marketing Ass'n v. Brohl*, U.S.App. Ct., 10th Cir., No. 12-1175 (Feb. 22, 2016) (petition

for writ of certiorari denied Dec. 12, 2016)].

Following *DMA*, additional states have followed Colorado's lead and asserted their own information reporting and notification requirements, including Alabama, Connecticut, Kentucky, Louisiana, Oklahoma, Rhode Island, South Dakota,

Tennessee, Vermont and Washington.

These requirements typically require notifying customers about their purchases, while some states also provide for reporting information about the customers' purchases to the state tax department.

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In addition to these new information reporting and notification requirements, while the physical presence nexus standard outlined in *Quill* was historically thought to be well-settled for sales and use tax purposes, several states

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have attempted to expand their nexus by adopting “economic nexus” laws that require out of state sellers to collect use tax if a certain threshold of sales are made into a state.

States asserting this economic nexus include Alabama, Indiana, Maine, Massachusetts, North Dakota, Ohio, Rhode Island, South Dakota, Tennessee, Vermont, Washington (business and occupation tax) and Wyoming.

In a significant departure from *Quill*, these economic nexus standards seek to impose a use tax collection requirement on out of state retailers with no physical presence in the state based on satisfying a certain level of sales to purchasers located within the state. These states are seeking to overturn the physical presence requirement provided by the U.S. Supreme Court in *Quill* to be able to require out of state retailers to collect and remit use tax on sales into their states. These states have some differences in their requirements, including various sales thresholds, procedures and effective dates.

Several of these provisions are being disputed in respective states, including

Alabama, Indiana and South Dakota. In a win for online retailers, on March 6, the South Dakota Sixth Judicial Circuit granted the remote sellers’ motion for summary judgment on the basis that the state was prohibited from imposing a sales and use tax collection requirement on remote sellers without a physical presence within the state under *Quill*. South Dakota appealed the decision to the South Dakota Supreme Court, which affirmed the trial court’s decision on Sept. 13. [See *South Dakota v. Wayfair, et al.*, 2017 S.D. 56 (S.D. 2017)].

The state is expected to seek U.S. Supreme Court review of the physical presence standard by the Dec. 12, 2017, deadline, plus potential extension of time to file.

Next Steps

These new positions taken by states impact online retailers’ sales and use tax compliance requirements, and state legislation, judicial disputes and federal legislation will continue to develop over the next few years. In addition, proposed federal legislation could potentially

either permit states to tax online retailers without a physical presence or prohibit them from doing so.

For example, the Marketplace Fairness Act of 2017 and Remote Transactions Parity Act of 2017 (both introduced April 27) have different standards, but generally would authorize states to require sales and use tax collection by most large out of state retailers. In contrast, the No Regulation Without Representation Act of 2017 (introduced June 12) would codify the physical presence nexus standard and prohibit economic nexus, click-through nexus, affiliate nexus and marketplace nexus.

Online retailers and their CPAs should monitor these developments to ensure compliance with their sales and use tax compliance obligations. 

William H. Gorrod and **Bradley R. Marsh** are shareholders at Greenberg Traurig, LLP in San Francisco, and focus their practices on state and local tax issues. You can reach them at gorrodw@gtlaw.com and marshb@gtlaw.com.