

WHAT IS LEFT AND WHAT IS RIGHT ABOUT NEXUS AND PUBLIC LAW 86- 272 AFTER WAYFAIR?

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AGENDA

- Overview of Federal Restrictions on State Taxing Jurisdiction
- Summary of *Wayfair*
- Sales and Use Tax Issues
 - LA Response
- Income Tax Issues ?

FEDERAL RESTRICTIONS ON STATE TAXING JURISDICTION

- States have the sovereign right to levy taxes subject to certain limits under federal law
- The U.S. Constitution contains certain restrictions, including:
 - The Commerce Clause
 - The Due Process Clause
- Congress can restrict the states' taxing jurisdiction under the Commerce Clause, specifically:
 - Public Law 86-272
 - The Internet Tax Freedom Act

FEDERAL RESTRICTIONS ON STATE TAXING JURISDICTION

- Under the Constitution, limits have been interpreted to vary depending on the nature of the tax at issue
 - Sales and use taxes
 - Income taxes
 - Gross receipts taxes
- Under federal statutory law, the statute itself defines the scope of the limitation on state taxing jurisdiction
 - Public Law 86-272
 - Income Taxes Only
 - Internet Tax Freedom Act
 - All “Taxes” within the Law’s Definition

SUMMARY OF *WAYFAIR*

- In *South Dakota v. Wayfair*, the U.S. Supreme Court struck down *Quill*'s physical presence rule.
 - The Court held that South Dakota's \$100K/200 transaction threshold was evidence of a "substantial nexus" between the state and Wayfair.
 - The Court also noted that South Dakota's law likely did not impose an undue burden on interstate commerce because, among other reasons, it explicitly prohibited retroactive application.
 - What open questions, if any, remain with respect to nexus and sales/use taxes?
- The case involved only South Dakota's sales and use tax.
 - How does *Wayfair* impact the constitutionality of income taxes?
- *Wayfair* only implicated the Commerce Clause.
 - How does *Wayfair* impact other constitutional and congressional limitations on state taxing Jurisdiction?

SUMMARY OF *WAYFAIR*

- Guiding dormant Commerce Clause Principles
 - State regulation may not discriminate against interstate commerce
 - Per se invalid
 - State may not impose undue burden on interstate commerce
 - State law that regulates even handedly to effectuate a legitimate local interest will be upheld unless the burden on interstate commerce is clearly excessive in relation to the putative local benefits (*Pike v. Bruce Church*, 397 U.S. 137 (1970))

SUMMARY OF *WAYFAIR*

- *Quill* is flawed on its own terms
 - Physical presence rule not necessary interpretation of the substantial nexus requirement
 - Creates rather than resolves market distortion
 - Imposes arbitrary, formalistic distinction disavowed by modern Commerce Clause jurisprudence
- “Extraordinary imposition by judiciary on States’ authority to collect taxes and perform critical public functions”
 - Judicially created tax shelter

SUMMARY OF *WAYFAIR*

- *Stare decisis* rejected
 - Court may not prohibit a state from exercising its lawful power in our federalist system
 - Inappropriate to ask Congress to resolve a false constitutional premise created by the Court
- Congress can resolve any problems associated with overturning
- *Quill* and *Bellas Hess* overruled

SOUTH DAKOTA V. WAYFAIR – HOLDING

- Creation of a Substantial Nexus Sufficiency Test
 - For purposes of the substantial nexus prong of *Complete Auto Transit v. Brady*,
 - “[Substantial nexus] is established when the taxpayer [or collector] ‘avails itself of the substantial privilege of carrying on business’ in that jurisdiction.”
- Taxpayers satisfied test
 - “[B]ased on both the economic and virtual contacts”
 - “[R]espondents are large, national companies that undoubtedly maintain an extensive virtual presence”
- Remanded to South Dakota Supreme Court

SOUTH DAKOTA V. WAYFAIR – HOLDING – NEW SUBSTANTIAL NEXUS SUFFICIENCY TEST

- New undefined types of contacts
 - “Substantial virtual connections”
 - “Extensive virtual presence”
 - Passive vs. Interactive?
 - Targeting required?
 - Non-economic contacts?
 - Tacit endorsement of “Cookie Monster” nexus
- Minimum threshold undefined for lower courts to determine
 - How much contact is enough?
 - *Wayfair* now only existing guidance
 - No fact specific analysis in *Wayfair* opinion

SOUTH DAKOTA V. WAYFAIR – HOLDING – NEW SUBSTANTIAL NEXUS SUFFICIENCY TEST (CONT.)

- Distinction between Commerce Clause and Due Process
 - Muddies or removes the distinction between Commerce Clause and due process analysis?
 - Similar to income tax economic nexus cases?
 - Similar to due process minimum contacts and purposeful availment?
 - Unrelated?

SOUTH DAKOTA V. WAYFAIR – HOLDING – NEW SUBSTANTIAL NEXUS SUFFICIENCY TEST (CONT.)

- Other Commerce Clause Principles
 - *Pike v. Bruce Church* undue burden analysis required even if *Complete Auto* test satisfied?
 - Regulation vs. tax levy
- Retroactivity
 - Constitutional decision retroactive
 - Limits on retroactivity?

NEXUS ISSUES POST *WAYFAIR* – SALES AND USE TAXES

- Most states have adopted thresholds comparable to those approved in *Wayfair* (South Dakota)
 - But S Dakota’s thresholds (\$100K/200 transaction) do not apply in every state
 - Ex: The Kansas Department of Revenue asserts that its long-arm statute automatically adopted *Wayfair*—but because the Legislature has not adopted the same thresholds, the Department asserts that a remote seller with a single sale to a purchaser in the state creates nexus (Kansas Attorney General disagrees)
- If physical presence is not required to create nexus with the state, what is sufficient?
 - When throwing out *Quill*’s physical presence test, did the Court also overrule *National Geographic*?
- Do thresholds apply to “marketplace facilitators”?

SOUTH DAKOTA V. WAYFAIR – SALES AND USE TAX IMPLICATIONS

- Roadmap
 - Safe harbor for those who transact limited business;
 - No retroactivity;
 - Reduced administrative and compliance costs by:
 - Requiring single, state level tax administration;
 - Requiring uniform definitions of products and services;
 - Requiring simplified tax rate structures, and other uniform rules;
 - Is Streamlined Membership required?
 - Access to software paid for by the state; and
 - Sellers who choose to use that software immune from audit liability

SOUTH DAKOTA V. WAYFAIR – SALES AND USE TAX IMPLICATIONS (CONT.)

- State Responses
 - Streamlined states with economic nexus laws generally planning to enforce
 - Other states
 - Measured response?
 - Following roadmap?
 - Legislation required?
 - Negotiated prospective compliance?
 - Non-sales tax states' reactions

SOUTH DAKOTA V. WAYFAIR – SALES AND USE TAX IMPLICATIONS (CONT.)

- Potential issues
 - Mass. and Ohio “cookie monster” nexus
 - No impact on notice and reporting requirements
 - Local enforcement (e.g., Colorado and Louisiana)
 - Lack of safe harbor
 - Nexus threshold?
 - Marketplace facilitators
 - Prospect of multiple dealers
 - Multiple sets of guidance required?
 - Ongoing audits, existing assessments and pending litigation

LOUISIANA'S RESPONSE TO WAYFAIR— SALES AND USE TAX

- Louisiana Sales and Use Tax Commission for Remote Sellers created by Act 274 of 2017 Regular Session
 - Responsible for administration and collection of state and local sales and use taxes related to “remote sales”
 - Created to provide uniformity and simplicity in sales and use tax compliance for “remote sellers”
- Act 5 (H.B. 17) 2018 Second Extraordinary Session
 - Amends the definition of “dealer” in La. R.S. Sec. 301 to include a remote seller and contains an economic nexus provision
 - Amends La. R.S. 339 to allow the Louisiana Sales and Use Tax Commission for Remote Sellers (LSTUCRM) to operate post-*Wayfair*
 - Not effective until final decision by U.S. Supreme Court on constitutionality of South Dakota’s law in *Wayfair*, which did not occur

SOUTH DAKOTA V. WAYFAIR – SALES AND USE TAX IMPLICATIONS (CONT.)

- LSTUCRM currently meeting monthly
 - Current target date for Mandatory Collection is July 1, 2020 enforcement date
 - No authority to bind localities
- Contrast with Uniform Local Sales Tax Board
 - Previously issued guidance to Local Collectors Counseling against Retroactive Collection
 - Addressing issues for vendors with nexus

LOUISIANA'S RESPONSE TO WAYFAIR

- Remote Sellers Information Bulletin No. 18-002
(Dec. 18, 2018)
 - Defines “Remote Seller”
 - Defines triggers (thresholds) for Qualification (as a “Remote Seller”) subject to registration/collection requirements
 - Requests voluntary compliance using Direct Marketer return (R-1031) until the Commission completes its work
 - Using 2018 and 2019 sales data to determine when compliance triggered
 - References Marketplace Facilitators (and Walmart.com case), and suggests their voluntary registration and collection in accordance with RISB 18-002
- Enforcement date currently set for July 1, 2020

LOUISIANA - ULSTB (VENDORS WITH NEXUS)

- Uniform Local Sales Tax Board
 - Act 274 (H.B. 601) 2017 Second Extraordinary Session
 - Establishes the Louisiana Uniform Local Sales Tax Board
 - Seeking to create more uniformity
 - Mandates
 - Proposed VDA regulation issued Dec. 20, 2018
 - Considering method for making the Board the starting point for taxpayers that want to file refund claims in multiple parishes; Board would administer the claims but will not make the decision for each parish on refund
 - Taxpayer's seeking a PLR for two or more parishes can go through the Board; Ruling would be binding but subject to judicial review by impacted collectors
 - Policy Advice
 - Issue how to provide when no authority to bind parishes so will issue informal announcements
 - Advice on correct administration of law to specific facts
 - Has adopted policy and procedure to respond to rules and regulations issued by the LDR
 - Funding challenge
 - *West Feliciana Parish Government v. State of Louisiana, Office of Motor Vehicles*, Case No. 661532 Sec. 25 (19th Jud. Dist. Ct. Feb. 4, 2018)
 - Judge ruled from the bench that the dedication of local taxes to fund the Board violates Article VI, Section 29 of the Louisiana Constitution, which prohibits local taxes from being used for a purpose other than the purposes set forth in the ballot measure for the tax and approved by voters; a written decision was issued but appears to be missing
 - Oral Arguments heard in Supreme Court on Oct. 22, 2019

LOUISIANA'S RESPONSE TO WAYFAIR

- Act 360 of the 2019 Regular Session
 - Defines "Remote Seller" - "A remote seller means a seller who sells for sale at retail, use, consumption, distribution, or for storage to be used for consumption or distribution any taxable tangible personal property, products transferred electronically, or services for delivery within Louisiana but does not have physical presence in Louisiana And is not considered a dealer as defined by R.S. 47:301(4)(a) through (l)."
 - Provides that remote sellers may temporarily use the "Direct Marketers Return"

LOUISIANA'S RESPONSE TO WAYFAIR– MARKETPLACE PROVIDERS

- Marketplace Provider legislation introduced in 2019 Regular Session but did not pass
- *Normand, v. Wal-Mart.com*, Dkt. No. 769-149 (La. 24th Judicial Dist. Ct. March 2, 2018) - Marketplace facilitator was a dealer for purposes of Louisiana sales and use tax laws solely because it engaged in solicitation of a customer market and despite that fact that it never owned or sold the good at issue
- *Normand vs. Wal-Mart.com USA, LLC*, 14-1250 (La. App. 5 Cir. 12/27/2018) - LA Fifth Circuit Court of Appeal affirmed ruling that the definition of dealer in LA R.S. 47:301(4)(I) applies to a marketplace facilitator
- *Normand vs. Wal-Mart.com USA, LLC*, 14-1250 (La. Sup. Ct.) –oral arguments heard 10/22/19

LOUISIANA'S RESPONSE TO *WAYFAIR*– MARKETPLACE PROVIDERS

- *Lerner New York, Inc. v. Newell Normand*, Dkt. No. L00393 (La. Bd. Tax App. Jan. 8. 2019)
 - Taxpayer with in-parish stores not permitted to report its on-line sales into the parish on the direct marketer return because did not satisfy the definition of direct marketer

NEXUS ISSUES POST *WAYFAIR* – INCOME TAXES

- Did *Quill*'s physical presence rule apply to income taxes?
 - No
 - *See, e.g. J.C. Penney v. Wisconsin* (1940); *International Harvester v. Wisconsin* (1944).
 - Economic nexus may depend on the state's definition of "doing business" or "engaged in business"
- To what extent does *Wayfair* impact state income tax nexus laws?
 - Adoption of specific economic nexus standards for income taxes?
 - Should economic nexus standards be the same for income and sales/use taxes under the Commerce Clause or otherwise?

DUE PROCESS CONSIDERATIONS

- The earliest limitation on state taxing authority recognized by the U.S. Supreme Court was the Due Process clause.
- Due process requires “definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax.” *See Miller Bros. v. Maryland* (1954).
- Exercise of jurisdiction should not offend “traditional notions of fairplay and substantial justice.”
- *Quill* was reaffirmed a physical presence standard for sales/ use tax but also required nexus under both Commerce Clause and Due Process Clause
 - The *Wayfair* Court did not overturn this holding in *Quill*, but did state that the two restrictions “may not be identical or coterminous, but there are significant parallels” between the two
 - In theory, could have nexus for Commerce Clause purposes but not Due Process Clause purposes

DUE PROCESS CLAUSE

- For income tax purposes, the Court has historically held that Due Process Nexus is satisfied if the “the state has given anything for which it can ask return.” See *J.C. Penney v. Wisconsin* (1940).
 - Does *Wayfair* change anything here?
- For sales tax purposes, if a remote seller makes a single sale into the state, and that sale exceeds the economic thresholds in the state, does this automatically satisfy Due Process nexus requirement?
 - *Wayfair* does not address (also doesn’t address with respect to Commerce Clause nexus)
 - What if *Wayfair* decision only addresses South Dakota’s law *as applied to Wayfair*?
- For purposes of the taxation of trusts, Due Process nexus is not met simply by actual presence of beneficiaries. What about “economic” or “virtual” presence of the trust or beneficiaries?
 - *North Carolina Department of Revenue v. Kimberly Rice Kaestner 1992 Family Trust* (2019)

PUBLIC LAW 86-272 AND THE INTERNET TAX FREEDOM ACT

- P.L. 86-272: Prohibits a state from imposing a “**net income tax**” if the “only business activities” in the state is the “solicitation of orders . . . for sales of tangible personal property”
 - P.L. 86-272 applies only to a “net income tax”
 - Only addresses sellers of “tangible personal property”
- Internet Tax Freedom Act: Prohibits states from imposing, among other things, a “discriminatory tax,” including a tax that “imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means.”
 - Tax under ITFA is “any charge imposed by any governmental entity for the purpose of generating revenues for governmental purposes, and is not a fee imposed for a specific privilege, service, or benefit conferred.”

PUBLIC LAW 86-272 & WAYFAIR

- How to reconcile the two?
 - *Wayfair* specifically addresses sales and use tax, while P.L. 86-272 specifically addresses income tax
 - Since nexus is different for sales/use and income tax, why would *Wayfair* have any implications for P.L. 86-272?
- In November 2018, the Multistate Tax Commission’s Uniformity Committee formed a Work Group to update its guidance related to P.L. 86-272 in light of the changing economy. MTC seems to be viewing *Wayfair* as relevant to P.L. 86-272
 - MTC Work Group will consider whether specific activities exceed “solicitation”
 - If exceeds solicitation, then reviewing sourcing
 - MTC Report to the Uniformity Committee (April 2019) - “if an in-state customer interacts with the remote business’s website (*i.e.*, does more than just view a presentation on the website), the business has engaged in activities in the state.”
 - Key considerations in reaching this conclusion: “The analysis in *South Dakota v. Wayfair, Inc.* speaks to the ‘continuous and pervasive virtual presence of retailers’ in the states where their customers are located.’

PL 86-272, ITFA & *WAYFAIR*

- MTC Work Group Report hypotheticals said to exceed P.L. 86-272:
 - Seller maintains a website offering for sale only items of tangible personal property. The products are complicated to use and purchasers often need post-sale assistance. Seller provides assistance in only one of the following ways:
 - Seller identifies a toll-free number on its website, and purchasers may call the number to speak to a customer assistance representative (who is located out of state).
 - Purchasers may either email or engage in electronic chat sessions with a customer assistance representative through the seller’s website.
 - Seller’s website includes an interactive tool which allows customers to type in a question. In response, the system (without human intervention) either asks follow-up questions or provides an answer.
- Compare toll-free number support with interacting with customer support through an electronic chat tool
- What is a “discriminatory tax” under the Internet Tax Freedom Act? Could the seller avoid engaging in an in-state activity—and therefore still operate within the bounds of P.L. 86-272—if the customer support is provided over the phone?

QUESTIONS?

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