States' online tax laws continue to prompt lawsuits

David M. Kall | Thursday, April 13, 2017

There is no end in sight for legal challenges to state government efforts to tax remote sales. The latest involves a lawsuit that Bloomberg made available online, filed by NetChoice and the American Catalog Mailers Association. They say that a new Tennessee administrative rule violates the precedent established in the now familiar 1992 U.S. Supreme Court case, *Quill Corp. v North Dakota*, which made it unconstitutional for states to impose a use tax collection duty on out of state sellers with no physical presence in that jurisdiction.

The new administrative rule that the suit is premised on contains a nexus provision calling for "[o]ut-of-state dealers who engage in the regular or systematic solicitation of consumers in this state through any means," with sales to in-state consumers of more than $500,000, to register with the Department, and collect the applicable sales and use taxes on those sales. The registration requirement was effective on January 1, 2017, and the tax collection obligation kicks in on July 1, 2017.

The complaint seeks a declaration that the rule violates the commerce clause by forcing collection and reporting obligations on retailers "whose only connection with the state is communicating with customers via…telephone, U.S. mail, common carrier, and now the Internet."

Further, the plaintiffs point out that the physical presence requirement in *Quill* has not been overturned. Thus, the rule "usurps the role of Congress in regulating interstate commerce, and unlawfully expands the State's taxing authority over companies, individuals, and organizations located throughout the United Sates, and potentially the world, based solely on their having customers in Tennessee."

According to a filing form, Tennessee argues that the purpose of the rule is to protect its "tax base and fiscal health as remote sales continue to increase each year. This rule also ensures that the State's economy remains strong and that all businesses selling to Tennessee consumers compete on a level playing field."

In addressing constitutional concerns contained in some comments forwarded pursuant to the

rulemaking process, the Department opined that its measure does not violate *Quill* in light of subsequent developments. These include various case outcomes, the unfair tax advantages that out-of-state retailers have over their in-state competitors, and the decreasing costs of compliance and remittance obligations, not to mention Tennessee's, and other states' heavy reliance on sales tax revenues.

On April 10, 2017, the court ordered that the rule be temporarily suspended.

South Dakota

These names of the plaintiffs in the Tennessee suit may sound familiar. They also sued the South Dakota Department of Revenue, in the spring of 2016, for its law, SB 106. SB 106 created a taxing obligation when an out-of-state retailer's sales in the Mount Rushmore state exceed $100,000, or 200 separate transactions. We addressed that case most recently last month, at which time we also noted that a NetChoice executive criticized Colorado's sales tax notice and reporting requirements, which were challenged but ultimately upheld in *Direct Marketing Association v. Brohl*, as "tattle-tale."

The South Dakota case has taken a predicted turn and is on its way to the state Supreme Court, by way of a notice of appeal, again posted by Bloomberg, that the South Dakota Department of Revenue recently filed. The article suggests that observers expect this step, required by the challenged statute, to be nothing but a formality in anticipation of the next one, an appeal to the U.S. Supreme Court. South Dakota's hope is that the high court overturns *Quill*, giving states more control over how and when to tax out-of-state sales.

North Dakota

The Peace Garden state's legislature recently passed SB 2298, which Gov. Burgum signed on March 10, 2017. The online sales taxing measure provides for the same thresholds as South Dakota's. However, the bill text also provides that it will only take effect when the U.S. Supreme Court overturns Quill, or that body issues an opinion in some other case "confirming a state may constitutionally impose its sales or use tax upon an out-of-state seller in circumstances similar to those specified" in SB 2298.

Massachusetts joins the fray

In early April, the Massachusetts Department of Revenue posted Directive No. 17-1 on its website, explaining that "[a]n Internet vendor with a principal place of business located outside the state is required to register, collect and remit Massachusetts sales or use tax with respect to its Massachusetts sales." Massachusetts sales are defined as "all sales made by the vendor of tangible personal property or services delivered into the state, however consummated."

Like Tennessee's rule, the Directive applies to sellers with more than $500,000 in annual sales, but adds in the requirement that there must also be at least 100 transactions, effective as of January 1, 2018. Prior to that, the Directive applies when, for the six-month period of July 1, 2017 to December 31, 2017, a seller met those thresholds in the previous 12 months.

In a somewhat novel argument, the Massachusetts Department of Revenue asserts that "Internet commerce was an unknown phenomenon" when *Quill* came out, and that its standards only apply to mail order vendors. Because Internet vendors' businesses and activities are "factually distinguishable," the Department contends that *Quill*'s limitations are not applicable to its Directive.

It is likely that there will be a prompt challenge to this Directive, even if there has not been one yet. One possibility some are already speculating about is action pursuant to the Internet Tax Freedom Act (Act). Signed into law in 1998, and extended repeatedly thereafter, the Act prohibits discrimination against electronic commerce, and the taxation of Internet access fees.

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