South Dakota: Online sales tax case now in US Supreme Court's hands

David M. Kall | Thursday, October 12, 2017

We posted an article not even a month ago describing South Dakota's latest loss in the ongoing dispute between the state on one hand and several internet retailers on the other, over the permissibility of taxing online sales. After the oral arguments, which we also detailed, the South Dakota Supreme Court did not take long to reach its conclusion: that the state did not have the authority to impose sales and tax laws on the retailers, Wayfair, Overstock.Com, and Newegg, because they lack a physical location there. South Dakota vowed to take its next, and last possible step, to the United States Supreme Court.

And so it has. Last week, South Dakota's Attorney General, Marty Jackley, issued a press release announcing that he had filed his cert petition, which Bloomberg posted on-line, asking the high court to overrule the long-standing physical-presence requirement set forth in the 1992 case *Quill Corp. v. North Dakota. Quill* prevents states from requiring externally located retailers to remit taxes for sales made within.

In his press release, Attorney General Jackley underscored the problem: "[t]he retail landscape significantly changed with the inception of the internet and access to online shopping. Federal law currently shields out-of-state businesses from remitting the same taxes as South Dakota businesses. Today the State asks the U.S. Supreme Court to level the playing field…The explosion of omnipresent online retailers and vast technological changes since *Quill* call for an end to the physical presence requirement. If the U.S. Supreme Court ultimately strikes down *Quill*, retail sales tax obligations can be applied fairly to both internet and main street businesses."

States have taken various but similar approaches in their laws. South Dakota's, SB 106, requires remote sellers with no physical location in South Dakota to remit sales tax, and follow all procedures of the law, if they meet one of two criteria in the previous calendar year or the current calendar year:

1. The remote seller's gross revenue of sale of tangible property, any products transferred electronically, or services delivered into South Dakota, exceeds $100,000.
2. The remote seller has 200 or more separate transactions tangible property, any products transferred electronically, or services delivered into South Dakota.

This case has implications beyond South Dakota. Every jurisdiction that is short on revenues is looking for better ways to sustain the basic functions of government. New tax collections on millionaires, marijuana, sugary soda beverages, and bike purchases, are not only controversial, but may not quite be doing the job. This is especially true when states are offering millions - or billions - in tax subsidies for economic development projects; think Amazon. Fluctuating costs associated with wildfires, hurricanes, and low oil prices are among other contributors to states' shaky fiscal positions.

Volatility is another big problem for states

Beyond these problems, state tax revenue streams are volatile, particularly with respect to state income taxes. In October 2014, Pew Charitable Trusts published an article titled "Volatile Income Tax Revenue Stumps States," in which the authors attributed unpredictability, in part, to the fact that so much tax revenue comes from high earners, "who are disproportionately affected by economic booms and busts."

Even if state's tax collections have recovered somewhat since the recession, and in fact are expected to rise, the authors asserted that this growth "is anemic compared to years preceding the recession. Overall revenues in the top 10 most income tax-dependent states have grown only 5.25 percent since 2009, S&P reported, compared to growth rates of an average of 9.32 in 1980-1989, and 5.7 percent in 1990-1999."

Pew organized the S&P data into a chart comparing the annual tax revenue growth between 1950-1979, and since 2009, for these ten most tax dependent states:

State	1950-1979	Since 2009
California	10.91	7.16
Colorado	10.06	6.68
Connecticut	10.09	7.33
Georgia	10.81	2.57
Massachusetts	9.89	4.97
Missouri	9.07	2.04
New York	9.26	3.28
North Carolina	9.45	3.74
Oregon	9.49	6.52
Virginia	10.36	3.68

Still quoting S&P, the Pew article declared that the "…problem gets worse. 'Because it is a structural economic problem, it is unlikely that states can fully correct for it solely by adjusting their tax policies…The volatility (in income taxes) coupled with the decline (in income tax revenue growth) is a nasty combination.'"

Fast-forward a few years, and Pew now has a "workable solution" to offer. Discussing the matter with Bloomberg, two Pew officials contend that states will be better off by "studying their revenue fluctuations and developing policies to manage their impact."

The pair explained that "four of the most common revenue streams are personal income, sales, corporate income, and severance taxes," each with a different level of volatility. Also, certain states have a specific and unique flavor of volatility. For instance, Alaska's revenue depends heavily on severance taxes from oil production, the price of which fell 75 percent in 2015. Thus, every state needs to understand "how to manage the ups and downs of tax revenue so that budgeting can be predictable and policy goals can be achieved." Oklahoma and Maryland are two states that have had some success doing this.

In Oklahoma, in 2016, the governor signed legislation calling for the creation of a Revenue Stabilization Fund, when revenue recovers, by setting aside above average tax collections from oil and gas production, and corporate income taxes. This will allow it to save money when it can, and modify the amounts it sets aside from year to year, depending on its fiscal situation.

As for Maryland, a 2016 examination of revenue fluctuations by the state's Department of Budget and Management, Department of Legislative Services, and comptroller, "concluded that personal income tax collections tied to non-withholding income, such as capital gains and dividends, significantly contributed to the unpredictability of tax revenue." Lawmakers responded with legislation to "limit the amount of non-withholding income that flows to the general fund. If this income exceeds the previous 10-year average, the excess amount will be put into the state's rainy day fund."

This is good news. As Bloomberg puts it, "revenue volatility is inevitable, but that does not mean… [that states] …are at the mercy of uncertainty."

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