taxnotes® state & local

Volume 89, Number 3 ■ July 16, 2018

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Reprinted from *State Tax Notes*, July 16, 2018, p. 241

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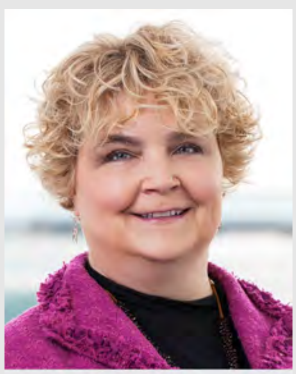

Diann L. Smith

In Raising the Bar, *State Tax Notes* commentary editor Doug Sheppard interviews four seasoned state and local tax veterans: Joe Crosby of MultiState Associates, Kendall L. Houghton of Alston & Bird LLP, and Stephen P. Kranz and Diann L. Smith of McDermott Will & Emery. All four interviewees were staffers with the Council On State Taxation.

In this edition of Raising the Bar, the four ponder the future of state and local sales and use taxes in the wake of *Wayfair* as well as the implications of Justice Anthony M. Kennedy's resignation.

Kendall L. Houghton: In the week after the *Wayfair* decision and before we realized that Justice Anthony M. Kennedy was retiring from the U.S. Supreme Court, we were each busily preparing thought pieces, client advisories, and the like. Have you seen anything in that group discussion and exchange of ideas that has surprised you in light of the way you understand the impact of *Wayfair*?

Diann L. Smith: Surprised? I don't think so. Hayes Holderness, who's a law professor now and used to be an associate at McDermott Will & Emery, published an interesting discussion noting that the Court was not asked to, and did not, distinguish between the idea that the case involved a sales tax and the traditional concept of the use tax. The Court said that everybody agrees that the sales at issue were taxable. Hayes's position is that because the case involved a sales tax and a remote vendor, the application of a sales tax should not be taken for granted. I find his focus on the transaction versus the taxpayer interesting. It's probably kind of niche and a technical argument, but that's why I find his analysis sticks out of the mainstream responses.

Stephen P. Kranz: I have been surprised at the difference of opinion regarding the decision's impact on streamlined versus non-streamlined states. And as someone who spent most of the last 20 years working with the business community and states to support simplification efforts, my background brings to light a personal bias in reading the opinion; it appears to me to be a very strong blessing of states that have engaged in simplification through the streamlined effort. And it does not communicate the same blessing for other states. It's clear that state tax policymakers believe that all states got the win in their read of the decision. As those discussions progress, I suspect we will see practitioners and businesses say, "No, that's not necessarily the case, there's still work to be done if you are not already a member of Streamlined."

That message is not what people want to hear, but it's an important message, and to the extent states want to avoid future challenges to exercise of jurisdiction over out-of-state taxpayers, they need to do three things articulated by the Court: prevent retroactivity, establish a small-seller threshold, and provide simplification or ease of the administrative burden. Now, the Court didn't say those were mandates, but the justices did spend a lot of time in the decision talking about each of them. And it appears to me to be the road map for states that want the same authority as South Dakota.

Houghton: I agree with you, Steve, and those three features that you just identified would inform the Court's determination whether South Dakota or any other state's tax system would be deemed to discriminate against — or impose an undue burden — on interstate commerce. So if a state only satisfied two of those three prongs, then I think the Court did leave open the question whether its system could survive a taxpayer challenge. To the extent that remote sellers — whether of goods, services, or any type of sale — have viewed this decision as being negative in some respects (of course not all taxpayers view it that way), they do need to recognize the Court's emphasis on the easing of administrative burdens for sellers that are not physically based in a state. And I think that that encouragement rang through all of the opinion, actually. So that is important.

Now, Steve, you're appropriately distinguishing between states that are members of the Streamlined Sales and Use Tax Agreement and states that are not, but what about localities? It has occurred to me that a locality is going to need to package its justification of tax collection obligations on remote sellers without being able to rely on that prong, given that no local jurisdictions have adopted, or adopted in effect, the agreement.

Kranz: They have not, and you're spot-on, Kendall. The states that do not have local jurisdictions with home rule authority are more closely aligned with the streamlined states' level of simplification. Those like Colorado that do have localities with autonomous authority should think seriously about centralizing the administration of their local taxes if they want the authority that was granted by *Wayfair*.

And it's not an easy job to rank the states' and localities' risk. Do remote sellers need to collect for each of these jurisdictions? We as practitioners are all looking at the relevant questions: Does the jurisdiction have economic nexus? Do they have a threshold? Have they promised not to go retroactive? Is the sales tax system that they're currently administering more burdensome or less burdensome that South Dakota's — or the same, even if they're not a streamlined state? The Court didn't say, "You have to join Streamlined," but I think it did say that it is important that you implement certain simplifications and technology solutions to facilitate tax collection if you want to ask out-of-state sellers to collect your tax.

Joe Crosby: We were all involved with Streamlined from its inception, and I agree with Steve that it would be better for the business community and for the states if all states conformed to the SSUTA.

Adopting the agreement obviously reduces the cost of collection for businesses, given the simplification and uniformity, but also indirectly in diminishing the potential audit exposure from errors of interpretation. States benefit because a simpler system leads to greater and more accurate voluntary compliance, and thus tax collections.

All that said, I don't read the decision to require a state to adopt SSUTA. Conforming to the agreement was clearly a beneficial factor for South Dakota, but another state with an already simple system, or a more complex state such as Alabama that adopted its own simplified system for use tax collection, may pass muster.

Which begs the question of who would file suit in these other states? A victory wouldn't result in the refund of taxes, but merely in requiring the state to further simplify. That is a laudable goal, but it is an expensive way of achieving it.

Smith: We've seen at least four states give a July 1 implementation date following *Wayfair*. Do they think that that's fair to remote sellers?

Kranz: It depends on the seller. Is it a seller that has a technology solution in place? And I suspect, given that some of those four states are members of Streamlined, they do have certified service providers; CSPs should be able to move quickly to implement and begin collecting. And the streamlined states have been very vocal about their willingness to be flexible and to accommodate systems changes, system implementation, and the delays that that may necessitate from a collection perspective. So if a company is concerned about those states, it should reach out through either a technology provider or a service provider to try to get more time, and I can't imagine the states right now being unwilling to give more time to companies who are wanting to collect tax.

Crosby: October 1 seems to be a reasonable compromise to me. If a state already has in place a statute that it believes allows it to require remote sellers to collect, and it issues a notification that it will enforce its law as of October 1, it allows two-plus months for businesses to come into compliance while not "missing" the revenue from the holiday shopping season. The July 1 enforcement dates — or, in the case of Massachusetts, reaffirming its October 1, 2017, enforcement date — seem unduly harsh, especially without any explicit process to come into compliance now and waive past liability. Especially since use taxes may have been paid on those transactions.

That said, larger sellers already have systems in place and shouldn't have been caught off guard by the decision. Overstock announced it would begin collecting immediately, and in doing so it echoed South Dakota's argument, perhaps unintentionally, that *Quill* itself effectively hindered interstate commerce by providing a benefit to companies that constrained their physical footprint.

Smith: Kendall, you had asked a question about is anything that people are commenting on surprising. I think there's also the question of was there anything in the opinion that was surprising. The thing that really surprised me was the Court's decision to say that *Quill* was wrongly decided from the beginning. I think the Court so easily could have said that regardless of whether *Quill* was rightly decided in 1992, because of the change in technology and the change in the retailer market, the physical presence standard is no longer the right standard today. But the Court went out of its way to say it was wrong when it decided *Quill*. That surprised me.

Houghton: Yes, I think that's a really good point, Diann. Even though all of us attended the oral argument in this case — we discussed the argument in a prior Raising the Bar column — there was a significant degree of uncertainty being displayed by various justices, or perhaps flexibility in terms of their opinions. It didn't seem as easy to predict the outcome, walking out of the Court the day of oral argument, as I would have expected to feel when I was walking in. But that said, and to your point, I think there was a really interesting exchange between the majority and the minority on the *stare decisis* point as well. Maybe it felt easier to the majority to move away from *stare decisis* when you can say, "Look, they just got it wrong and that means that the *stare decisis* reliance is even less compelling than it would otherwise have been." But I thought that was an interesting tension on display in these opinions.

And whether it matters for us on a go-forward basis is probably another thing, right?

Smith: Right. Steve, I know you were at the National Conference of State Legislatures Task Force and State and Local Taxation meeting. What other types of discussions have gone on there?

Kranz: There was much celebration by the states over the Court's decision. Which states qualify is still an issue that they're working through, and I suspect that that discussion will progress through next year's state legislative sessions. In conjunction with the discussion of *Wayfair*, there was discussion of the Supreme Court's decision in *Murphy* and what it meant. There was a professor from Georgetown who spoke about *Murphy*'s implications for the Sensenbrenner bill, which would codify *Quill*, and that it was likely going to face problems, given *Murphy*, that the Marketplace Fairness or the Remote Transactions Parity Act did not face. And then, interestingly, the Internet Tax Freedom Act and some of the other federal protections that we've grown up relying on as practitioners and taxpayers may face challenges by the states.

So in the same term, the Supreme Court granted the states significant authority over remote sellers, and gave them a possible tool to challenge preexisting federal legislation that curtails their authority. We are suddenly a global economy with subnational control over important tax policy decisions.

Smith: And next term, we now know we're going to have a case that really is going to try to determine what "states' rights" means. They've accepted *Hyatt* again, which pits Nevada's idea of its rights against California's idea of its rights.

Houghton: Steve, you just mentioned ITFA, and you mentioned a number of the sales/use tax remittance-focused bills that have been reintroduced serially over the last couple of years. What do you think are the prospects for the Business Activity Tax Simplification Act [BATSA], and business activity tax nexus generally?

Kranz: Well, to the extent that Public Law 86-272 would face a challenge under *Murphy*, I suspect that BATSA would also face a similar challenge. Talking about that in the context of *Wayfair*, I think many of us believe that for business activity tax nexus purposes, the Court's decision lands more on the side of *Quill* does not apply, and economic nexus is the rule for all tax types. So I suspect BATSA will have new life even though its support had waned over the last decade.

Houghton: Yes, and that's an interesting dynamic — as you say, in light of this *Wayfair* decision, if everybody agrees that economic nexus is an applicable standard for taxes other than sales and use, then BATSA becomes that much more relevant to parties who are looking to manage the direct burdens of being engaged in interstate commerce.

Crosby: Justice Kennedy helped the states in multiple ways, and his retirement is the latest gift: Congress will not have much time to consider whether it should respond to *Wayfair* while it is working to fill Justice Kennedy's seat.

But there is another issue that will complicate Congress's decision that I haven't seen reported. Several states — mainly those controlled by Republicans — have statutes adopted in the mid-2010s that require them to use additional revenues from remote sales taxation to reduce personal income tax rates.

The Wisconsin Legislative Fiscal Bureau just analyzed this very issue. The bureau estimated the additional revenue that the state would generate based on an October 1 date to commence collection, opined that *Wayfair* could be reasonably construed as "any federal law," thus triggering Wisconsin Act 20, and then estimated the reductions in personal income tax rates that would be implemented once those revenues are collected.

If those rate reductions are implemented, or even announced, congressional action to limit this newfound state authority could be characterized as increasing personal income taxes. There's more than a bit of irony in there. And a huge political hurdle.

Smith: There is a line in *Quill* that could give taxpayers some hope. While its effect becomes a little muddled later on in the opinion, the Court says that complexity could itself be discrimination against interstate commerce. That's a concept I don't think we've really seen before; I mean, some people have suggested that under *Pike* balancing, if something is very complex, that might raise undue burden issues, but complexity has not been linked with discrimination before. The Court does later go on to say that in this case; because the tax is applied against both in-staters and out-of-staters, discrimination is not an issue. Nevertheless, I think we may see some cases in the future using this idea of complexity as discrimination.

Houghton: Maybe we should turn to the development of Justice Kennedy's retirement from the Court after 30 years, and the combination of his concurrence in *Direct Marketing Association v. Brohl* and the *Wayfair* decision, which some say could not have happened but for his concurrence in *DMA*. Are these what he'll be remembered for in the state tax community? Or do you think there are other decisions that we shouldn't ignore in assessing his impact on our area of practice?

Kranz: In my lifetime, *Wayfair* is the high-water mark, and what I think our generation of tax professionals will recall.

Doug Sheppard: Speaking of *Wayfair*, I have a question about the retroactivity issue. Is some of the business community's fear justified? And if it is, under what circumstances do you think a jurisdiction would go after retroactive sales or use taxes?

Kranz: We've already seen people claiming that Massachusetts is going retroactive given its announcement on its preexisting guidance regarding cookie nexus. I think, practically speaking, most of the states recognize that true retroactive enforcement of the *Wayfair* standard would be problematic — not just in terms of challenges to assessments and further litigation, but such irresponsible behavior could spur Congress to act as they did following *Northwest Portland Cement* and pass federal legislation restricting state authority. So my hope is that all the states will hold together and act responsibly given their new authority — and apply it prospectively. So far I haven't seen, other than the arguments over Massachusetts, any indication that states intend to go retroactive.

Houghton: Steve, that said, I do think that as advisers to taxpayers, we have to nevertheless be sensitive to the potential that a state could make the argument that *Quill*, in fact, had not provided protection to certain remote sellers that would have been deemed to have had commerce clause substantial nexus under the *Quill* standard. And in those circumstances, if a company had physical presence that was more than de minimis, and it just had never registered to collect and remit, that might be a fact pattern in which the retroactive assessment of liability could occur. But I think a state would need to clearly delineate those factual grounds — not that it was in fact applying its new economic-presence-type standard to that taxpayer on a retroactive basis. Do you agree with my distinction?

We need to be vigilant to be able to assess what's going on, if it appears that an assessment is retroactive in effect.

Smith: I think that's right. ■