



GLENN HEGAR TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

July 5, 2018

**Wayfair and the Ability of Texas
to Require Remote Sellers to Collect Sales and Use Taxes**
South Dakota v. Wayfair, 585 U.S. __ (6/21/18)

Press Contact: Chris Bryan or Kevin Lyons at 512-463-4070
Legislative Contact: Nikki Cobb at 512-463-7252

Summary of the Decision

In a 5-4 decision, the U.S. Supreme Court overruled two prior decisions that held that a state can only impose sales and use tax collection responsibilities on sellers of goods and services when they have a physical presence in the state. *See Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) and *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967).

The decision means that states—and local jurisdictions—can now impose tax collection responsibilities on sellers who have an economic presence. For example, a state could decide that out-of-state sellers have to collect and remit sales and use tax once they make total sales into the state of \$250,000 during the prior calendar year.

The Court remanded the case for further proceedings, which means the case is not final, and there could be other litigation on the question of when a state or local jurisdiction can require remote sellers to collect and remit sales and use taxes.

The decision noted that prior Supreme Court cases impose two key limits on state authority regarding the taxation of interstate commerce, which are still good law:

1. States may not discriminate against interstate commerce, which essentially means states may not treat out-of-state sellers worse than in-state sellers; and
2. States may not impose undue burdens on interstate commerce, the meaning of which is an open question as further explained below.

The Court also affirmed that states cannot impose collection responsibilities on sellers unless the tax applies to an activity with a substantial nexus with the state, which means the seller “avails itself of the substantial privilege of carrying on business” in that jurisdiction. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) and *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1 (2009). The court held that

Wayfair, along with Overstock.com and Newegg, who also challenged the South Dakota law at issue, had sufficient nexus with South Dakota based on their economic and virtual contacts with the state.

The court noted that applying a tax retroactively could cause discrimination and undue burden on interstate commerce, but it was not an issue for the court to resolve at this time.

In addition, Congress has authority under the Commerce Clause of the U.S. Constitution to address these issues, which means Congress could choose to respond to the *Wayfair* decision by passing laws to change the outcome.

The court did not determine exactly what constitutes an undue burden on interstate commerce, but noted that the South Dakota law in question “includes several features that appear designed to prevent discrimination against or undue burdens upon interstate commerce” as follows:

1. A small seller exception. The law only applies to sellers that deliver more than \$100,000 of goods or services into South Dakota or engage in 200 or more separate transactions for the delivery of goods and services into South Dakota annually;
2. The law is not retroactive; and
3. South Dakota is a member of the Streamlined Sales and Use Tax Agreement. (Texas is not a member and could only become a member through legislative action.) The agreement provides for, among other things, uniform definitions of certain products and services, simplified tax rates and immunity from audit liability for sellers that utilize sales tax administration software paid for by the state members.

What the Comptroller is Doing Now

We are proceeding carefully and deliberately to fully understand this historic decision, while seeking input in order to implement the new law in a way that best serves the state of Texas, our citizens and the businesses already operating here. We welcome input from all stakeholders, including:

1. Legislators;
2. Texas retailers;
3. Remote sellers and marketplace providers who are currently not collecting;

4. Local taxing jurisdictions;
5. Our Taxpayer and Business Advisory Groups; and
6. Trade associations and other affected parties.

We are reviewing agency rules that need amending to, for example, explain the amount of economic nexus in sales and/or transactions required to create a safe harbor for small sellers. We intend to adopt new rules under our current legal authority in early 2019, but this could change depending on issues that arise during the rulemaking process.

We will not apply the new law retroactively to remote sellers that have no physical presence in Texas; we want a smooth transition and a successful partnership with remote sellers who start collecting and remitting Texas taxes. We will provide ample notice to remote sellers as to when they need to start collecting and remitting.

Considerations for the Legislature

We are reviewing Texas statutes the Legislature may consider updating when it convenes in 2019. We will continue to work with state legislators to ensure they are fully briefed on our progress.

With appropriate notice, and prior to legislative action, Tax Code § 151.107(a)(5) (Retailer Engaged in Business in the State) could be imposed on remote sellers to the extent they “[solicit] orders for taxable items by mail or through other media,” meaning, for example, sellers who solicit sales in Texas through catalogs and emails.

We suggest the Legislature consider reviewing the following provisions, which could help address the legal requirement that states not impose undue burdens on remote sellers:

1. Amend the definition of “seller” and “retailer” in Tax Code § 151.008 (“Seller” or “Retailer”) to include marketplace platforms used by third-party sellers and provide adequate liability protection for the marketplaces that collect and remit for those sellers.
2. Amend Tax Code § 151.059 (Fee Imposed in Lieu of Local Sales and Use Taxes), which currently allows a nonresident (remote) seller to pay a fee based on a weighted average local sales and use tax rate in lieu of collecting local sales and use tax based on actual local tax rates. This statute currently only applies to a change in collection responsibilities based on the passage of

- federal legislation, not to changes in federal law based on a court case such as *Wayfair*.
3. Amend Tax Code § 151.107(c), which is a companion provision to § 151.059. This statute imposes a collection responsibility on sellers of only tangible personal property, and not taxable services, if federal legislation passes.

Fiscal Impact

We expect that state and local jurisdictions will see tax collections increase because of the *Wayfair* decision, but the amount depends on several questions raised by the decision that are yet to be resolved relating to, for example, eliminating undue burdens on remote sellers. More specific estimates will be provided as the implementation and legislative process continues.

An estimate developed in 2014 projected that up to \$840 million in state sales taxes in fiscal 2017 would be uncollected by remote sellers through all channels, including catalogs, emails and phone. There have been significant changes in the online marketplace during the last four years. As a result, the *Wayfair* decision does not mean the state will collect the amount estimated in 2014. More specifically, the prior estimate needs to be considered in light of the following factors:

1. In the past year, some remote sellers have volunteered to collect in anticipation of the *Wayfair* decision or for other reasons. For example, some taxes are now being collected due to the fall 2017 amnesty program sponsored by the Multistate Tax Commission nexus program for third-party sellers using Amazon's online marketplace.
2. Growth in internet sales in recent years has been concentrated among the largest retailers, most of which already collect Texas sales and use taxes.
3. A portion of taxes on remote sales will never be collected because the sales will be under the economic nexus threshold for small sellers, which is yet to be determined in Texas.
4. There will always be some non-compliance by remote sellers, just like there is continued non-compliance by some in-state sellers.
5. There will be some gain depending on the agency's implementation of the new law and related legislative action.
6. *Wayfair* is already collecting in Texas. Overstock.com has announced it will start collecting in all jurisdictions across the country because of the *Wayfair* decision.