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What's Next?

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Jan. 11, 2018

How did we get here?

Historically, state budgets have relied heavily on sales and use taxes, emphasized by the fact that aggregate sales and use tax collections account for over 30 percent of total state tax revenues. Sales and use taxes are some of the most stable and reliable as a revenue stream – with aggregate national collections only falling during periods of significant economic downturn such as the recession of 2008.

Not surprisingly, states have attempted to expand sales and use tax collections by increasing rates (often unpopular and unsuccessful with voters), expanding the sales tax base to professional services and other traditionally exempt items, increasing “sin taxes” (sales taxes on cigarettes and alcohol), requiring use tax notification and reporting of remote seller sales, and pushing the boundaries of traditional sales and use tax nexus concepts. Concerning the latter, states have enacted new sales and use tax nexus laws in response to the changing digital economy (and tax revenue lost due to remote commerce) through concepts such as “click-through nexus,” so-called “cookie nexus,” and employing broader applications of affiliate nexus. Most significantly, however, states have begun to directly challenge the physical presence nexus standard laid out in the 1992 U.S. Supreme Court case, *Quill Corp. v. North Dakota*.

In his concurrence to the U.S. Supreme Court’s 2015 opinion in *Direct Mktg. Ass’n v. Brohl* – a case out of Colorado challenging use tax reporting requirements – Justice

Kennedy concluded that the combination of tax loss from individual purchase use

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Quill Corporation was a mail-order distributor of office equipment and supplies that maintained a physical presence in California, Georgia and Illinois. Quill sold its products into North Dakota through ads, catalogs and telemarketing, but maintained no locations, warehouses, employees, or other property in the state – essentially no physical presence. Customer orders were shipped to the state through the U.S. Mail or a designated common carrier.

The North Dakota tax code at the time defined a “retailer” as any person who engaged in regular or systematic solicitation in the state and required those “retailers” to collect the use tax from the customer at the time of the purchase. Quill did not collect the use tax on its sales made to its mail-order customers in North Dakota, a requirement that the North Dakota Tax Commissioner tried to enforce.

The primary issue on appeal to the U.S. Supreme Court was whether North Dakota could require an out-of-state mail-order retailer with no physical presence in the state to collect a use tax on goods purchased by North Dakota customers. The U.S. Supreme Court ruled that under the Commerce Clause of the U.S. Constitution, an out-of-state seller cannot be required to collect and remit sales tax on remote sales made to an in-state purchaser unless the seller has established a physical presence in the purchaser's state. Significantly, the court also indicated that Congress had the authority to overrule the court's decision in regards to the Commerce Clause – authority that Congress has yet to exercise.

In 2015, states began to move against Quill

Alabama and South Dakota brought two of the first significant state challenges to *Quill*.

In October of 2015, and likely in response to Justice Kennedy's concurrence, the Alabama Department of Revenue adopted a regulation establishing sales tax nexus

for remote retailers if the retailer's in-state sales meet a specified threshold and the

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[South Dakota Economic Sales and Use Tax Nexus Litigation](#)

On March 22, 2016, South Dakota Governor Dennis Daugaard signed legislation requiring certain remote sellers with no physical presence in the state to collect and remit sales tax on sales to South Dakota customers effective May 1, 2016. The South Dakota Department of Revenue subsequently began mailing notices to remote sellers requiring collection and remittance of sales taxes on sales to South Dakota customers. The notices were followed by the Department filing a declaratory judgment action against three remote internet retailers in Hughes County Circuit Court. That action automatically enjoined the enforcement of the law during the pendency of the litigation.

After an attempt to hear the case in federal court failed, the Hughes County Circuit Court struck down the law. The South Dakota Supreme Court subsequently affirmed the circuit court's decision in September 2017. A further appeal to the U.S. Supreme Court is anticipated. For more information on the South Dakota economic sales and use tax nexus law and litigation, please read our alert, [South Dakota takes aim at Quill](#).

Alabama and South Dakota's economic sales tax nexus laws are the first laws deliberately challenging the long-established principles of physical presence nexus. Litigation in these cases will likely move through the court systems quickly, as the states are looking for swift determinations on expanding remote sales tax collections.

Economic sales and use tax nexus landscape

In addition to Alabama (the first regulatory action) and South Dakota (the first

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alert [Indiana enacts economic sales tax nexus provisions](#).

- The Maine legislature overrode the governor's veto to enact an economic sales and use tax nexus law effective Oct. 1, 2017. The Maine law provides that a declaratory judgment action would enjoin enforcement of the nexus provisions during the pendency of the action. For more information on the Maine law, please read our alert [Maine enacts economic sales tax nexus provisions](#).
- The North Dakota legislative assembly enacted an economic sales and use tax nexus law similar to South Dakota's economic nexus law. However, the North Dakota provision only becomes effective contingent on the U.S. Supreme Court overturning *Quill* or otherwise confirming that a state may constitutionally impose a sales and use tax on remote sellers. For more information on the North Dakota law, please read our alert, [North Dakota lays groundwork to challenge Quill 25 years later](#).
- The Tennessee Department of Revenue promulgated a regulation requiring remote sellers without physical presence to register by March 1, 2017 and begin collection by July 1, 2017. However, the regulation was challenged and enforcement of the provision is currently stayed pending the outcome of the litigation. For more information on the Tennessee regulation, please read our alert, [Tennessee finalizes economic nexus sales tax rule](#).
- Vermont enacted a statute similar to South Dakota that becomes effective the *later* of July 1, 2017 or after the U.S. Supreme Court or federal legislation abrogates the physical presence requirement established by *Quill*. For more information on the Vermont statute, please read our alert, [Vermont continues the assault on Quill](#).
- The Wyoming legislature enacted an economic sales and use tax nexus law on March 1, 2017, effective on July 1, 2017. That law requires remote sellers to collect and remit sales tax on sales to Wyoming customers if, within the current or preceding calendar year, the sellers' gross revenue from the sale of tangible

personal property, admissions or services delivered into the state meet specific

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- The Washington state legislature enacted an election effective Jan. 1, 2018 for remote sellers that have at least \$10,000 of sales into the state. Those remote sellers may either comply with use tax notice and reporting requirements or choose to collect and remit sales taxes. Penalties for noncompliance are significant. For more information on the Washington statute, please read our alert, [Washington enacts use tax reporting and B&O changes for remote sellers](#).

As of the date of this article, the Pennsylvania General Assembly also passed an election for remote sellers similar to Washington state's provision. That bill is currently under consideration by the governor.

All 50 state legislatures were scheduled to be in session in 2017. A number of economic sales and use tax nexus laws were proposed through the mid-year point, including Arkansas, Georgia, Hawaii, Idaho, Maryland, Massachusetts, Mississippi (currently in process of promulgating an economic sales tax nexus regulation), Nebraska, North Carolina, North Dakota, and Utah, among others.

What's next?

Economic sales and use tax nexus really first came to light in 2015 with a U.S. Supreme Court concurrence and a state regulation. In 2016, a state economic nexus statute was first enacted – and challenged. The 2017 legislative year was poised to see direct *Quill* challenges gaining momentum as a number of proposed economic nexus laws are addressed by state legislatures and taxing authorities.

These laws and subsequent challenges may cause Congress to consider acting on federal legislation under the threat that states all across the country could respond by enacting their own laws subjecting remote sellers to collection obligations creating an even further fragmented compliance landscape for online retailers. However, federal remote seller proposals have made little progress in Congress the

last few years, with only the Marketplace Fairness Act of 2013 earning a U.S. Senate

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litigation in the state to enjoin the law or wait for a U.S. Supreme Court decision that reaffirms *Quill*. Obviously, the risks of noncompliance are high. The U.S. Supreme Court may choose not to rehear a *Quill* challenge, or even overturn *Quill*, leaving the economic sales and use tax laws in place, or up to Congress to override.

Expanded nexus laws are primed to impact businesses with physical presence in just one state, or only a handful of states, and making sales into many states. New registration, collection and remittance obligations require a business's tax function to be acutely aware of the states with these new economic nexus laws, the effective dates of the laws, the various triggering sales thresholds, and whether the law is on hold due to pending legal challenges. Until the U.S. Supreme Court or Congress provides some finality on economic sales and use tax nexus laws, states will continue to enact those provisions at an ever-increasing pace, further muddying the once certain sales and use tax nexus landscape.

Learn more at <http://rsmus.com/what-we-do/services/tax/state-and-local-tax/sales-and-use-tax/economic-sales-and-use-tax-nexus-laws.html>.

Brian Kirkell is a principal and Mo Bell-Jacobs is a manager at RSM US LLP. They are leaders in the firm's Washington National Tax practice, focusing on state and local tax issues.

Sales Tax

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