

Remote Seller Sales & Use Tax Update: Marketplace Fairness Act Reintroduced

April 3, 2015

Overview

A bipartisan group of U.S. Senators recently introduced the Marketplace Fairness Act of 2015 (S. 698; the “MFA 2015”).¹ If adopted into law, MFA 2015 generally would make it easier for a state to collect sales and use taxes from sales made by out-of-state or “remote” sellers (such as catalog or online retailers) that do not have an in-state physical presence. Similar legislation was approved by the U.S. Senate in the 113th Congress, but was not passed by the U.S. House of Representatives before the 113th Congress concluded on January 3, 2015, resulting in the need to re-introduce the legislation in the 114th Congress.

In this Tax Alert, we summarize MFA 2015 and highlight other recent developments concerning remote seller nexus for sales and use tax purposes.

Proposed Marketplace Fairness Act of 2015

If adopted, MFA 2015, which is substantially similar to the Marketplace Fairness Act of 2013, would authorize Streamlined Sales and Use Tax Agreement (“SSUTA”)² member states to enact laws requiring remote sellers to collect and remit sales and use taxes³ with respect to “remote sales.”⁴ If a state is not an SSUTA member, the state would be able to exercise such authority if the state adopts certain “minimum simplification requirements” relating to the administration of the tax, including a single audit for all state and local taxing jurisdictions within the state, a single sales and use tax return and uniformity of the tax base.⁵ A non-member state would also be required to provide remote sellers with free software for calculating sales and use taxes due on each transaction (at the time the transaction is completed) and for filing state sales and use tax returns.⁶

Small businesses would be exempt under MFA 2015 if their annual gross receipts from remote sales in the U.S. do not exceed \$1 million.⁷

Other significant provisions of the proposed MFA 2015 include the following:

- A statement that MFA 2015 shall not be interpreted to create any nexus or alter the standards for determining nexus.⁸
- An acknowledgement that remote sellers may deploy or utilize a certified software provider of their choice.⁹
- Adoption of a cascading sourcing rule to determine the location where a product or service is sold, which is based on where the item sold is received by the customer.¹⁰

¹ S. 698, 114th Cong. (2015). The text of MFA 2015 is accessible at: <https://www.congress.gov/bill/114th-congress/senate-bill/698/text>.

² The SSUTA attempts to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance. There are currently 23 full-member states and one associate member. SSUTA states have agreed to a number of simplifying measures, including tax base uniformity and various tax base definitions. Additionally, the SSUTA provides uniform sourcing rules, simplified administration of exemptions, simplified tax returns and protection of consumer privacy.

³ S. 698, at Sec. 2(a).

⁴ The term “remote sale” is defined to mean “a sale into a State, as determined under the sourcing rules under paragraph (7), in which the seller would not legally be required to pay, collect or remit State or local sales and use taxes unless provided by this Act.” *Id.* at Sec. 4(5).

⁵ *Id.* at Sec. 2(b)(2)(A) & (B).

⁶ *Id.* at Sec. 2(b)(2)(D).

⁷ *Id.* at Sec. 2(c).

⁸ *Id.* at Sec. 3(b).

⁹ *Id.* at Sec. 3(c).

¹⁰ *Id.* at Sec. 4(7).

SSUTA member states would be able to exercise authority under MFA 2015 beginning 180 days after publishing a notice of intent to exercise such authority, but no earlier than the first day of the calendar quarter that is at least 180 days after the date of enactment of MFA 2015.¹¹ A state that is not an SSUTA member would commence its authority beginning no earlier than the first day of the calendar quarter that is at least six months after the date that the state enacts legislation satisfying the minimum simplification requirements.¹²

Proposed Online Sales Simplification Act of 2015

A discussion draft of the Online Sales Simplification Act of 2015 (spearheaded by House Judiciary Chairman Bob Goodlatte (R-VA)) was released on January 13, 2015,¹³ and sets forth an alternative approach for collecting sales and use taxes on remote sales. Unlike MFA 2015, the Online Sales Simplification Act of 2015 would employ an origin-based approach to sourcing that would allow sales to be taxed at the rate imposed at the location from where the taxable items are shipped.¹⁴ The discussion draft also provides that the seller would remit the collected sales taxes to the origin state.¹⁵ The taxes would then go through a clearinghouse and ultimately be turned over to the purchaser's state.¹⁶

States would be able to choose whether to participate in this method of collecting sales tax on remote sales by entering into a tax distribution agreement. However, if a state chooses not to participate, then the state would be prohibited from imposing sales tax on such sales by any other method.¹⁷

The Online Sales Simplification Act of 2015 would require a tax commission to be created to oversee how tax is collected and distributed among participating states.¹⁸

Proposed Remote Transaction Parity Act

Rep. Jason Chaffetz (R-Utah) has indicated that he will introduce the so-called Remote Transaction Parity Act that would, according to Chaffetz, authorize states to require sellers to collect sales taxes on remote sales. To participate, a state would be required to either become an SSUTA member or amend its sales tax law to implement certain simplification requirements. The proposal is expected to also include provisions directed at reducing the burden of audits by providing for single audits of retailers and by placing the initial duty to respond to audits on the software developers that furnish sales tax software to retailers.

Similar to MFA 2015, the Remote Transaction Parity Act would utilize destination-based sourcing by applying the sales tax rate at the location of the purchaser.

While MFA 2015 would exempt retailers with annual remote sales of \$1 million, the Remote Transaction Parity Act would provide an exemption for retailers with \$10 million in remote sales during the first year the proposed law is in effect, \$5 million in remote sales during the second year and \$1 million in remote sales during subsequent years.

Remote Seller Case Law Overview and Recent Developments

Nexus for Use Tax Collection Purposes Requires In-state Physical Presence

In *Quill Corp. v. North Dakota*, the U.S. Supreme Court held that before an out-of-state company can be obligated to register and collect state use tax, it must have "substantial nexus" in the taxing state.¹⁹ This substantial nexus standard derives from the Commerce Clause of the U.S. Constitution and requires some level of physical presence. In *Scripto, Inc. v. Carson*, the U.S. Supreme Court sanctioned the agency theory of nexus, finding that an out-of-state seller who used independent contractors to solicit business could be required to collect the state's use tax.²⁰ In *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue* the U.S. Supreme Court ruled that representatives performing activities on behalf of a seller while physically present

¹¹ *Id.* at Sec. 2(a).

¹² *Id.* at Sec. 2(b).

¹³ Online Sales Simplification Act of 2015, available at: <http://www.subnet.nga.org/downloads/1501HybridOriginDiscussionDraft.pdf>.

¹⁴ *Id.*

¹⁵ *Id.* at §2(b).

¹⁶ *Id.* at §3(a)(3).

¹⁷ *Id.* at §3(a)(4).

¹⁸ *Id.* at §3(a).

¹⁹ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

²⁰ *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).

in a state may create Business & Occupation tax nexus for a seller if such activities are significantly associated with the seller's ability to establish and maintain a marketplace in the state.²¹

Taken together, these U.S. Supreme Court decisions preclude a state from asserting the duty to collect sales or use tax upon an out-of-state seller absent proof that the out-of-state seller itself, or through an agent or representative soliciting on the out-of-state seller's behalf, is physically present in the state. In recent years, states have enacted nexus-expanding provisions that attach the physical presence of an in-state person to the remote seller. For example, "click-through" nexus statutes create a presumption of nexus for remote sellers who compensate an in-state company based upon a percentage of sales from referrals through the in-state company's website. The seller may rebut the presumption provided it can document the in-state person is not actively soliciting sales within the state on the seller's behalf. Similarly, affiliate nexus statutes create a presumption of nexus on behalf of a remote seller, who is under common ownership with an in-state affiliate, when the affiliates share common logos and trademarks or the in-state affiliate otherwise engages in activities that are deemed to expand the marketplace on behalf of the out-of-state affiliate.

Direct Marketing Association v. Brohl and Justice Kennedy's Concurring Opinion

In *Direct Marketing Association v. Brohl*, the U.S. Supreme Court reversed the decision of the U.S. Court of Appeals for the Tenth Circuit (the "10th Circuit").²² The 10th Circuit had held that the Tax Injunction Act ("TIA") (28 U.S.C. § 1341) deprived the U.S. District Court of jurisdiction to enjoin Colorado from enforcing its remote seller sales and use tax notice and reporting requirements.²³ The Supreme Court held that the TIA does not bar the suit brought by the Direct Marketing Association because the relief sought would not enjoin, suspend, or restrain the assessment, levy or collection of Colorado's sales and use taxes.²⁴ The Court remanded the case to the 10th Circuit for further proceedings.²⁵

Direct Marketing is significant both for its holding regarding the issue before the Supreme Court and for the concurring opinion of Justice Kennedy, which suggested a willingness to reexamine *National Bellas Hess, Inc. v. Department of Revenue of Illinois*²⁶ and *Quill*. As expressed by Justice Kennedy, the physical presence requirement established in *National Bellas Hess* and reaffirmed in *Quill* has created "what may well be a serious, continuing injustice faced by Colorado and many other States" with respect to a state's inability to require a business to collect sales and use taxes when the business does not have physical presence in the state."²⁷ Justice Kennedy reasoned further that although *Quill* reaffirmed *Bellas Hess*, in reaching its decision the *Quill* majority acknowledged that but for *stare decisis*, "contemporary Commerce Clause jurisprudence might not dictate the same result" as that rendered in *Bellas Hess* given the Court's more recent and refined test elaborated in *Complete Auto Transit, Inc. v. Brady*.²⁸ According to Justice Kennedy, "the *Quill* majority acknowledged the prospect that its conclusion was wrong when the case was decided."²⁹

Justice Kennedy went on to emphasize that he believes *Quill* is "inflicting extreme harm and unfairness on the States" as they are unable to collect much of the taxes on purchases from out-of-state retailers.³⁰ Specifically, he noted that California estimates that it collects only 4% of the use taxes due in respect to sales from out-of-state vendors.³¹ According to Justice Kennedy, the Internet has caused "far-reaching systemic and structural changes in the economy" and, "[a]s a result, a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term."³² Given these changes, Justice Kennedy stated: "it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*[,] . . . [a] case

²¹ *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987).

²² *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124, 1134 (2015), *rev'g* 735 F.3d 904 (10th Cir. 2013).

²³ *Direct Mktg. Ass'n v. Brohl*, 735 F.3d 904.

²⁴ *Direct Mktg. Ass'n*, 135 S. Ct. at 1127, 1134.

²⁵ *Id.* at 1134. For more on *Direct Mktg. Ass'n v. Brohl*, see our [Tax Alert dated Mar. 5, 2015](#).

²⁶ *National Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753 (1967).

²⁷ *Direct Mktg. Ass'n*, 135 S. Ct. at 1134.

²⁸ *Id.*, citing *Quill*, 504 U.S. at 311; *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

²⁹ *Direct Mktg. Ass'n*, 135 S. Ct. at 1134.

³⁰ *Id.*

³¹ *Id.*, at 1135

³² *Id.*

questionable even when decided [Accordingly, t]he legal system should find an appropriate case for this Court to reexamine *Quill* and *Bellas Hess*.”³³

Considerations

Remote sellers, as well as buyers, may want to consider whether their billing systems, purchasing systems, sales tax policies and compliance procedures are current and adaptable in the event that court action or federal legislation requires remote sellers to collect tax. Such considerations may include:

- Reviewing the nexus footprint to determine whether they are registered and reporting where required.
- Reviewing the taxability of revenue streams to ascertain whether tax is collected properly, and evaluating purchases to determine whether use tax is accrued properly.
- Automating sales tax collection and use tax accrual processes to help reduce errors.
- Outsourcing monthly and quarterly sales and use tax compliance.

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³³ *Id.* It is unclear how states will respond to Justice Kennedy’s request to find an appropriate case for reexamination. However, one state may have taken an initial step in this regard. The Washington State proposed budget, currently pending before the Washington State House of Representatives, would expand nexus beyond physical presence. As stated in the proposed budget, “the legislature intends by this act to address the significant harm and unfairness brought about by the physical presence rule by testing the boundaries of the rule. This act also sets up a legal challenge to the physical presence nexus rule that could potentially lead to the United States supreme court [sic] reevaluating *Bellas Hess* and *Quill* or congress enacting legislation authorizing and establishing the requirements for states to impose a sales tax collection duty on remote sellers.” WA H-2224 § 901(8) - (2015-16).