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Growing Pains for States' Online-Sales-Tax Plans

The Supreme Court last year allowed states to tax online retail sales. What kinds of sales, and how to tax them, remains a complicated question.



AP Photo/Ross D. Franklin, file

An Amazon.com fulfillment center in Goodyear, Ariz., in 2010

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Since the advent of e-commerce in the 1990s, states have been clamoring to charge sales taxes on online sales. But now that they're finally able to levy the taxes, their legislative challenges are just beginning.

Last June, the Supreme Court delivered a 5-4 decision in *South Dakota v. Wayfair* that allowed states to impose a tax on goods delivered to residents in their state even if the retailer doesn't have a physical presence in the state. Since then, most of the 45 states that levy a sales tax have enacted or proposed legislation to add some sort of online-sales-tax regime to their books.

The rollout has raised additional questions as to whether states should adopt South Dakota's court-approved definition of an online sale and its threshold at which companies must pay a sales tax. States have come up with a variety of answers.

"There are major areas that the states are struggling with right now as they rush to adopt statutes like South Dakota's," said Richard Pomp, a law professor at the University of Connecticut.

At first, states decided to adopt South Dakota's legislative language requiring businesses with more than \$100,000 in annual sales or 200 transactions within the state to collect and remit sales tax. Over time, though, issues with those metrics cropped up, and more states have begun to modify their language as small businesses got ensnared by the so-called sales-tax nexus.

"That was sort of the initial trend, to sort of flat-out adopt the South Dakota model," said Jennifer Weidler Karpchuk, senior counsel at the law firm Chamberlain Hrdlicka. "As time went on, some states started to adopt an 'and' test, so the remote seller had to have both the monetary threshold and the transaction threshold in the state in order to have nexus."

Other states like Pennsylvania, South Carolina, North Dakota, and Colorado have dropped the transaction requirement altogether. California is considering legislation to amend its rules—which went into effect April 1—to drop the transaction threshold and raise the sales threshold to \$500,000.

In some states, it's also unclear what kind of sales should get counted toward either the sales or transaction thresholds.

“There are a lot of questions as to which sales make up those thresholds,” said Jeff Glickman, partner-in-charge of the business advisory firm Aprio's state and local tax practice. “Do [sales tax]-exempt sales count? Do sales by nonprofits count? Do resales count?”

Glickman said some state tax authorities, such as those in Illinois and Indiana, are beginning to roll out guidance to help clarify their recently passed online-sales-tax legislation.

Some large internet retailers, like Amazon and eBay, often operate as a platform for third-party sellers to connect with buyers, and who's responsible for handling the tax bill remains an open question.

More than 30 states have also passed or are considering legislation establishing marketplace-facilitator rules, which would require online retail platforms to collect the sales tax for third-party retailers hosted on their site. Glickman said the thinking among states is that the online platforms are so involved in the transaction, they can be treated as essentially a co-vendor, equally liable to collect the sales tax.

But as with the first round of online-sales-tax bills, each state has its own take on the legislative language, and its own timeline for rolling out the measures.

“This is sweeping the country,” Pomp said. “The platform legislation is all different; it’s not monolithic. And sometimes it covers local sales taxes; sometimes it doesn’t.”

The provisions are different in each state, and not every state has taken up an effort to require platforms to collect from third-party retailers. That’s created confusion among small sellers, with many seeking help from Amazon’s and other platforms’ online forums, as well as state tax agencies, *Tax Notes* [reported](https://www.taxnotes.com/editors-pick/online-sellers-crowdsource-sales-tax-compliance-advice) (<https://www.taxnotes.com/editors-pick/online-sellers-crowdsource-sales-tax-compliance-advice>) in February.

“How do the economic-nexus rules fit in the with marketplace-facilitator rules? I think that’s one area of confusion,” Glickman said. “I think some states have been a bit more clear on that than others.”

Glickman added that there could be confusion over the documentation and reporting responsibilities between the platform and the third-party seller as well, and that states likely need to issue more guidance on the issue.

States and localities are also considering expanding the economic-nexus principles laid out in the *Wayfair* decision to other areas of taxation beyond sales taxes, such as income taxes and gross-receipts taxes, potentially capturing even more revenue from remote transactions.

Though some states have implemented similar rules before the *Wayfair* decision, last year’s Supreme Court ruling will likely embolden more states to expand their income-tax rules to include some remote transactions, analysts said.

The city of Philadelphia and the state of Washington have [implemented](https://www.chamberlainlaw.com/salt-blawg/philadelphia-wayfair-nexus-birt-regulations) (<https://www.chamberlainlaw.com/salt-blawg/philadelphia-wayfair-nexus-birt-regulations>) legislation that would impose business income taxes on companies that have no physical

presence in their jurisdiction but pass a certain threshold of economic activity there.

Hawaii is likely to soon join them. The state legislature sent a bill to the governor last week that would change its business income tax to mirror the standards set out in the *Wayfair* decision: \$100,000 in sales or 200 transactions. Hawaii implemented its online-sales-tax regime last year.

But Karpchuk said those moves may spark litigation, as companies may argue that the Interstate Income Tax Act of 1959—which prohibits states from imposing an income tax on companies if their activity is limited to soliciting business for the sale of tangible personal property—protects them from such taxation.

“I think the biggest problem from the income-tax side that we are going to see are questions of how far [the Interstate Income Tax Act] is going to apply to a remote seller,” Karpchuk said.

In Washington, lawmakers opposed to online sales taxes introduced legislation to override the state laws in both the last Congress and the current one, but tax-writing-committee leaders haven't appeared interested in taking up the effort. More likely, Glickman said, is legislation to either establish a higher, nationwide threshold before state sales taxes kick in for remote sellers.

But there are differing opinions in the state tax community as to whether the *Wayfair* decision will prompt Congress to focus on the issue and create a national standard for online sales taxes.

“They've had these kinds of issues in front of them for over a decade and have not been able to enact anything,” Glickman said. “The real question is whether or not this *Wayfair* decision really spurs that kind of action, and that's something that I think we'll have to wait and see about.