



**Statement of
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**Submitted to the
U.S. House of Representatives Committee on the Judiciary**

**Hearing on the State Tax Consequences
of the U.S. Supreme Court Decision in
*South Dakota v. Wayfair, Inc.***

The Honorable Robert W. Goodlatte, Chair

July 24, 2018

Introduction

Chairman Goodlatte, Ranking Member Nadler, and Members of the Committee, I am Douglas Lindholm, President & Executive Director of the Council On State Taxation, which is more commonly known as COST. I am submitting testimony on behalf of the members of COST to address the consequences to the business community – both intended and unintended – of the U.S. Supreme Court’s recent decision in *South Dakota v. Wayfair, Inc.* (June 21, 2018). I would like to thank you for convening a hearing in this Committee to address these important issues.

About COST

Formed in 1969, COST is a non-profit trade association consisting of approximately 550 multistate corporations engaged in interstate and international business. COST’s objective is to preserve and promote equitable and non-discriminatory state and local taxation of multi-jurisdictional business enterprises. COST has been an active participant in the long-running debate over the jurisdictional (nexus) standard for state taxes generally and for sales taxes specifically. We participated in the National Tax Association’s efforts to reconcile the *Quill* decision in the mid-90’s, testified before the Advisory Commission on Electronic Commerce in 1998, and have participated in state efforts to reduce sales tax burdens on interstate commerce through the Streamlined Sales & Use Tax Project from its inception in 2000. COST is also an active participant in the Business Advisory Council to the Streamlined Sales Tax Governing Board.

The *Wayfair* Decision

On June 21, the U.S. Supreme Court issued its opinion in [South Dakota v. Wayfair Inc.](#), a historic decision that overturned the “physical presence” test for determining whether a state has the authority to require a remote seller to collect sales and use tax within its jurisdiction. In a narrow five to four majority decision (written by Justice Kennedy and joined by Justices Thomas, Ginsburg, Alito, and Gorsuch), the Court overruled the *National Bellas Hess, Inc.* and *Quill* physical presence test that had been in place for 51 years and replaced it with an “economic and virtual presence” test that lacks both definition and scope. The Court held that the first prong of the four-part *Complete Auto* test requiring “substantial nexus with the taxing state” was satisfied because “the nexus is clearly sufficient based on both the economic and virtual contacts respondents have with the State.” Specifically, referring to South Dakota’s threshold (\$100,000 in sales or 200 transactions), the Court held that “[t]his quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on a business in South Dakota.”

While explicitly overruling the physical presence test, the Court left the door open for additional lawsuits under “some other principle in the Court’s Commerce Clause doctrine.” The Court recognized that those issues were not yet litigated or briefed and did not resolve them in its opinion. Instead, the Court vacated the lower court’s decision and remanded for further proceedings not inconsistent with its opinion. Presumably, the lower court will review South Dakota’s statute in light of the remaining three prongs of the *Complete Auto* test for evaluating

state taxes under the Commerce Clause, to wit: does the tax discriminate against interstate commerce; is it fairly apportioned; and is the tax fairly related to the services provided by the State. In two different sections of its opinion, the Court highlighted several features of South Dakota's law that "appear designed to prevent discrimination against or undue burdens upon interstate commerce." In doing so, the Court appears to have provided guidelines for other states to obtain remote seller collection authority and minimize litigation. These features include:

- A safe harbor for sellers who transact only limited business in the State;
- Non-retroactive application of remote sales tax collection; and
- Simplification and uniformity achieved through membership in the Streamlined Sales and Use Tax Agreement (SSUTA).

The Court described some of the benefits of SSUTA by citing to the following specific features:

- i. Standardized taxes to reduce administrative and compliance costs
- ii. Single, state level administration
- iii. Uniform definitions of products and services
- iv. Simplified tax rate structures
- v. Other uniform rules
- vi. Access to free sales tax administration software
- vii. Audit protections

Chief Justice Roberts (joined by Justices Breyer, Sotomayor and Kagan) authored a dissent, arguing the *Quill* precedent should not be overturned because of *stare decisis*, and that Congress was best suited to decide whether to depart from the physical presence rule. The dissent also stressed the importance of the still unresolved issues of the burdens on interstate commerce imposed by complex and non-uniform state and local tax systems.

Sales Tax Consequences of *Wayfair*

In the wake of the *Wayfair* decision states are grappling with how to impose collection responsibilities on remote sellers. Some states are viewing the Court's reference to the features of South Dakota's law designed to prevent discrimination against or undue burdens upon interstate commerce as a guide to obtaining remote seller collection authority while minimizing constitutional challenges. Other states are interpreting the Court's analysis as non-binding dicta, and appear determined to test the boundaries of what is necessary to obtain collection authority.

The disparity of state perspectives is apparent with regard to the issue of when to begin implementing remote seller collection authority. Some states are taking a thoughtful and deliberate approach, making sure remote sellers have a reasonable time within which to comply with the law. Other states (both SSUTA and non-SSUTA) believe they can enforce collection authority immediately, even though the *Wayfair* litigation is not final. And a few states have indicated there is at least a potential for retroactive application of remote seller collection laws.

The Streamlined Sales and Use Tax Governing Board held an emergency meeting last week at which it received public comments, a large portion of which consisted of questions and concerns about how (and when) remote seller collection laws would be implemented. Some of the twenty-three current SSUTA states appear genuinely interested in continuing to strive for uniformity and simplification through the SSUTA framework, while others have refrained from expressing similar intent. As a result, many participants, from both business and state government, are concerned there is no longer much incentive for the current SSUTA member states to continue to collectively seek reduced burdens for taxpayers through SSUTA, and even less incentive after *Wayfair* to convince the five largest sales tax states (CA, NY, TX, FL, & PA) to join the effort. Thus the current disparity in state and local sales tax laws and uncertainty surrounding implementation of remote collection are likely to continue to grow, creating more complexity, uncertainty, and unpredictability in the short term, and the inevitability of more court challenges over the long term.

State Income Tax Consequences of *Wayfair*

In addition to the sales tax consequences of the *Wayfair* decision, many taxpayers now face greater uncertainty regarding nexus for business activity taxes such as corporate income taxes. The U.S. Supreme Court's *Quill* decision was the only U.S. Supreme Court ruling affirming the physical presence test since the Court articulated its four-part test in *Complete Auto*, and the Court has never articulated a separate nexus requirement for business activity taxes. Many companies rely on the *Quill* physical presence standard for income tax nexus protection under the theory that there is only one Commerce Clause and thus there should only be one substantial nexus test. State laws and rulings are inconsistent on income tax nexus standards, and the uncertainty and unpredictability of income tax nexus standards is much greater after *Wayfair*. This uncertainty will likely result in increased compliance costs for both states and taxpayers, unless Congress provides a bright-line rule for corporate income tax nexus as previously proposed in the Business Activity Tax Simplification Act (BATSA). See, e.g., H.R. 2584, the Business Activity Tax Simplification Act of 2015.

Congress Can Play an Important Role

Congress currently has a unique opportunity to improve the efficiency and fairness of state sales taxes. As noted by Justice Roberts in the *Wayfair* dissent, "Congress has the flexibility to address these questions in a wide variety of ways ... [and] can focus directly on current policy concerns rather than past legal mistakes." If Congress enacts legislation to create a framework for sales tax simplification and uniformity within which states must operate, it could achieve the dual goals of improving sales tax administration and increasing the global competitiveness of the nation. If Congress chooses to exercise its Commerce Clause powers to modernize state sales tax systems, we recommend using SSUTA as a starting point. Its uniform tax base definitions, uniform sourcing rules, exemption certificate management, central administration provisions, and technology certification and indemnification provisions will provide a solid foundation on which additional simplification and uniformity can be achieved, while preserving state sovereignty regarding state tax bases and rates. SSUTA appropriately applies to all sellers and not just to remote sellers. In addition, Congress should address the other issues identified as important by the Supreme Court, including a transactional safe

harbor, non-retroactive application of remote seller collection responsibility, and other uniform rules that reduce burdens on taxpayers.

Modernizing the Sales Tax System: Beyond SSUTA

In a world economy in which growth-enhancing consumption taxes (as an alternative to income taxes) are on the ascendancy, an inefficient, complex, and disharmonized state sales tax can have a detrimental impact on our nation's ability to compete on a global basis. The United States suffers in comparison to its primary economic competitors on several key criteria of a well-designed, modern consumption tax: exemptions for business inputs; uniformity and simplification; and central administration. First, while states collect an average of 42 percent of their total sales tax revenue from business inputs, virtually all other countries avoid the pyramiding of consumption tax by providing exemptions or credits for business inputs. Second, a much higher level of consumption tax uniformity exists in Europe (harmonization through the EU) than in the United States, where the largest states (and some smaller ones) with nearly two-thirds of the U.S. population have not adopted SSUTA. Third, the U.S. sales tax system, with 45 state taxing jurisdictions (plus D.C.) and over 10,000 state and local taxing jurisdictions, is the most decentralized and complex consumption tax in the world.

Some of the inefficiencies and inequities in state sales tax systems can be addressed by Congressional legislation; others must be fixed by the states themselves. To accelerate the modernization of state sales tax systems and reinforce the mutual benefits for states and multistate businesses in doing so, COST has developed a Sales and Use Tax Scorecard that evaluates state adherence to sound policy principles for sales taxes. The Scorecard focuses on six categories that reflect a broad spectrum of fair, efficient, and uniform sales tax administration practices. While these categories overlap in part with the rules adopted by the SSUTA member states, they encompass a broad range of additional criteria that define an optimal sales tax system.

Conclusion

On behalf of our members, I thank you for the opportunity to submit testimony here today. After the *Wayfair* decision, Congress has a unique opportunity to encourage states to continue in their efforts to promote uniformity, simplicity, and procedural safeguards for taxpayers seeking to comply in an overly complex sales tax system. I have attached to this testimony two documents that you may find useful in your deliberations: the recently published "*The Best and Worst of State Sales Tax Systems: COST Scorecard on Sales Tax Simplification, Uniformity and the Exemption of Business Inputs*"; and a State Tax Notes article jointly authored with COST's General Counsel Karl Frieden entitled "*After Wayfair: Modernizing State Sales Tax Systems*". Again, thank you for your consideration, and we welcome any questions or follow-up materials COST may provide the Committee as it considers these important issues.