

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

MEMORANDUM

TO: Members, Subcommittee on Economic Growth, Tax, and Capital Access
FROM: Andy Kim, Chairman
DATE: February 28, 2020
RE: Subcommittee hearing entitled “*South Dakota v. Wayfair, Inc.*: Online Sales Taxes and their Impact on Main Street.”

The Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access will hold a hearing entitled, “*South Dakota v. Wayfair, Inc.*: Online Sales Taxes and their Impact on Main Street” on **Tuesday, March 3, 2020 at 10:00 a.m. in Room 2360 of the Rayburn House Office Building**. The hearing will focus on the impact to small firms as a result of the decision in *South Dakota v. Wayfair* regarding online sales taxes. In *Wayfair*, the Supreme Court overturned a previous ruling where it determined that states could only collect sales tax from businesses that had brick and mortar locations in those states. Members will have the chance to hear from witnesses about the United States Supreme Court’s landmark 2018 court ruling, how the law has been applied by the states, and its impact on small businesses.

Witnesses include:

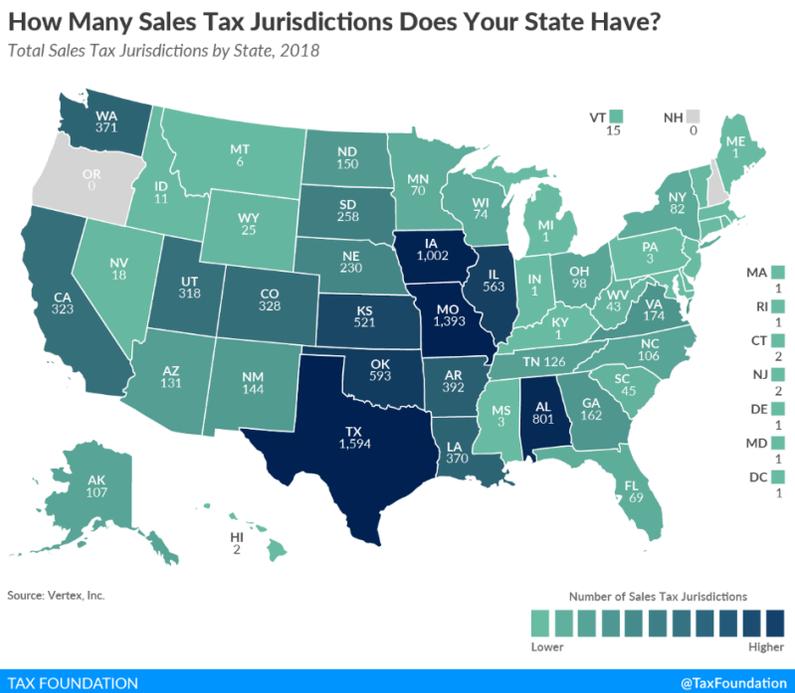
- Mr. Jamie Yesnowitz, Principal at Grant Thornton, LLP, Washington, DC, Testifying on behalf of the American Institute of Certified Public Accountants (AICPA);
- Mrs. Linda Lester, Vice President of K-Log, Inc., Zion, IL;
- Mr. Kevin Mahoney, President and Founder of FindTape.com, North Brunswick, NJ; and
- Mr. Brad Scott, Financial Director of Halstead Bead, Inc., Prescott, AZ

Background

Small business owners have long been a critical stakeholder in tax discussions. Small business owners generally have agreed with respect to tax policy center on having a low tax burden, decreasing the cost of tax compliance for all small firms, having a tax code that is simple to understand and tax policy that creates certainty for small businesses. One reason small firms face complexity and uncertainty is because many have to monitor and comply with federal, state, and local tax rules. This is especially true for small businesses that sell goods online and across state lines.

Currently 45 states and the District of Columbia (see Figure 1) levy sales taxes on the sale of goods, including goods sold over the internet.¹ When including local sales tax jurisdictions, there are over 10,814 unique sales tax jurisdictions across the country, including 1,594 in Texas, 1,393 in Missouri, and 1,002 in Iowa—alone.² The number of jurisdictions and the tax rates that the jurisdictions charge change frequently, making it extremely difficult for small businesses to comply with these numerous jurisdictions.³ Complicating matters is that, different jurisdictions also have different product definitions to assess sales tax. For example, knitters purchasing yarn in New Jersey pay sales tax on yarn purchased for art projects, but do not pay sales tax on yarn designated for sweaters.⁴ Prior to the *Wayfair* decision, states and localities were unable to collect sales taxes from out-of-state sellers that did not have an “adequate nexus” to the state. For over 50 years, nexus was defined as physical presence within a state. The U.S. Supreme Court upended that precedent in *Wayfair*, defining adequate nexus as when a remote seller “avails itself of the substantial privilege of carrying on business in that jurisdiction.”⁵ This set the stage for states and localities to implement their own online tax regimes impacting millions of small businesses.

Figure 1:



How Many Sales Tax Jurisdictions Does Your State Have?, Tax Found. (April 17, 2018), <https://taxfoundation.org/growing-number-state-sales-tax-jurisdictions-makes-south-dakota-v-wayfair-much-imperative/>.

¹ *State Sales Tax Rates*, SALES TAX INST. (February 1, 2020) <https://www.salestaxinstitute.com/resources/rates>.
² *New Sales Tax Report Shows an Increase in Rate Changes in First Six Months of 2019*, VERTEX (August 5, 2019) <https://www.vertexinc.com/company/news/new-sales-tax-report-shows-increase-rate-changes-first-six-months-2019>.
³ In fact, in the first six months of 2019 there were 335 sales tax rate changes alone, while there was 6,230 new and changed sales and use tax rates over the past 10 years. See *id.*
⁴ Brief for eBay, Inc., et al. as Amici Curiae 8, n. 3, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018).
⁵ *Id.*

History

The U.S. Supreme Court first wrestled with the issue of the collection of sales tax from out-of-state vendors in *National Bellas, Inc. v. Illinois Department of Revenue*, 386 U.S. 753 (1967). The Court, when deciding whether an out-of-state mail-order business with no physical presence in the state was required to collect and pay state sales tax held that a business must have a physical presence within a state's borders for the state to collect sales tax. This decision was affirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) with the Court articulating that the physical presence nexus under the Due Process Clause is established when an out-of-state seller's efforts are purposefully directed toward the residents of the taxing state.⁶

After the severe state revenue declines following the Great Recession, several states enacted nexus laws connecting remote vendors to the state, thereby allowing for the collection of sales and use taxes.⁷ Colorado enacted a statute which required retailers that do not collect Colorado sales or use tax to notify Colorado customers of their use tax liability. The Direct Marketing Association filed suit, challenging the law. The district court, citing *Quill*, overturned the law.⁸ The trial court's decision was appealed to the U.S. Supreme Court in *Direct Marketing Association v. Brohl*, 135 S.Ct. 1124 (2015). In its opinion, the Court yet again upheld *Quill*'s physical presence standard, but Justice Anthony Kennedy stated in his dissenting opinion that the legal system should find an appropriate case to reexamine the *Quill* standard.⁹

In light of *Brohl* and Justice Kennedy's dissent, a number of states, including South Dakota enacted laws with the explicit intent to prompt the U.S. Supreme Court to reconsider *Quill*.¹⁰ South Dakota's law required businesses who met a specified threshold of economic activity—\$100,000 in annual gross revenue or 200 or more in-state, separate, transactions—to collect and remit applicable sales and use taxes to the state. As soon as the law was enacted, South Dakota filed a declaratory judgment action against online retailers arguing that under the new law they should collect sales and use taxes in the state.¹¹ The trial court upheld the declaratory judgment and the South Dakota Supreme Court overturned the trial court's decision, citing *Quill*'s physical presence requirement.¹² The decision was appealed to the U.S. Supreme Court, which held on appeal that the *Quill* physical presence standard was incorrect, and should be overruled.¹³

Even though the majority contemplated the effect of its decision on small businesses, especially small businesses that make a small volume of sales to customers in a number of states, the Court dismissed this challenge, suggesting that software available at a reasonable cost would be available

⁶ *Id.* at 312. The Court noted that “[a]n overruling of *Bellas Hess* might raise thorny questions concerning the retroactive application of [sales and use] taxes and might trigger substantial unanticipated liability for mail[-]order houses.

⁷ See Matthew T. Szudajski, *The Rising Trend of Sales Tax Nexus Expansion*, 70 TAX LAW. 907 (2017) (discussing the rise in affiliate nexus and click-through nexus requirements); see also Avalara, *Sales tax laws by state: A seller's guide to nexus laws and sales tax collection requirements*, <https://www.avalara.com/us/en/learn/guides/2020-sales-tax-changes/stc-chapter-1-gated.html>.

⁸ *Direct Marketing Ass'n v. Brohl*, 735 F.3d 904 (10th Cir. 2013).

⁹ 135 S.Ct. 1124, 1135 (2015) (emphasis added).

¹⁰ See e.g., S.D. Codified Laws § 10-64-1 (Supp. 2016).

¹¹ *South Dakota v. Wayfair Inc.*, No. 3:16-CV-03019-RAL, 2017 WL 212644, at *1 (D.S.D. Jan. 17, 2017).

¹² 901 N. W. 2d (2017).

¹³ 138 S. Ct. 2080 (2018).

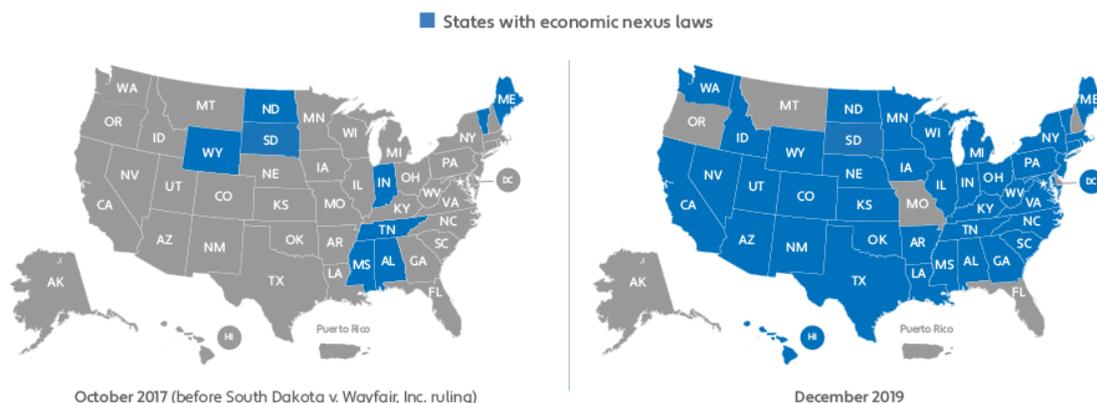
to help small businesses cope with their compliance issues.¹⁴ Chief Justice Roberts in his dissent clearly recognized the compliance burden that the majority was placing on the smallest of small businesses. His dissent predicted that small businesses would be a subject to a patchwork system that will “prove[s] baffling for many retailers”.¹⁵

Current Law

State Sales Tax Collection

Following the *Wayfair* decision, 43 states and the District of Columbia have adopted some type of state sales tax collection and remittance obligations for out-of-state vendors (see Figure 2).¹⁶ In these states and the District of Columbia, a single transaction can potentially trigger tax liability or can require a seller to file a return with the state. But, in a majority of these states, sellers with less than a specified threshold of sales or transactions are exempt from filing with the state and collecting and remitting state taxes.

Figure 2:



AVALARA, *2020 sales tax changes*, <https://www.avalara.com/us/en/learn/guides/2020-sales-tax-changes/stc-chapter-1-gated.html>.

Marketplace Facilitator Laws

38 states, plus the District of Columbia, have implemented marketplace facilitator laws that shift tax collection obligations from small businesses to the online marketplaces (Amazon, eBay, Etsy, etc.) that facilitate the sales (see Figure 3).¹⁷ These laws require marketplace facilitators to collect and remit sales tax for third-party sellers. But these laws do not require the marketplaces to collect and remit local sales taxes, placing the burden on small businesses to collect and remit these taxes.

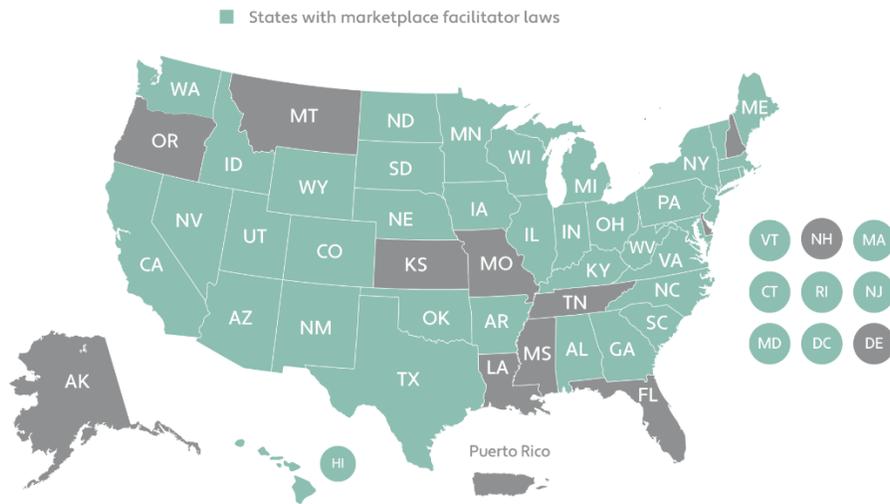
¹⁴ *Id.*

¹⁵ 138 S. Ct. 2080.

¹⁶ Jared Walczack & Janelle Cammenga, *State Sales Taxes in the Post-Wayfair Era*, The Tax Found. (December 2019) <https://files.taxfoundation.org/20191212152919/State-Sales-Taxes-in-the-Post-Wayfair-Era-PDF..pdf>.

¹⁷ *Id.*

Figure 3:

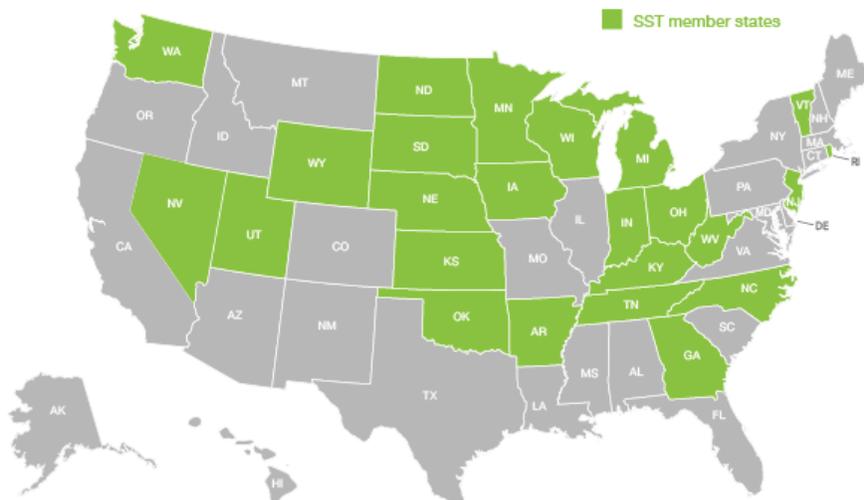


AVALARA, *State-by-State guide to marketplace facilitator laws*, <https://www.avalara.com/us/en/learn/guides/state-by-state-guide-to-marketplace-facilitator-laws.html>.

Streamlined Sales and Use Tax Agreement

Even though 23 states have signed onto the Streamlined Sales and Use Tax Agreement (SSUTA), which is a national effort by state and local governments to establish uniform sales and use tax standards, the top six sales tax collection states by population—California, Texas, Florida, New York, Illinois, and Pennsylvania—have not joined the agreement (see Figure 4).

Figure 4:



AVALARA, *What is Streamlined Sales Tax, and why should you care?* (April 22, 2019) <https://www.avalara.com/us/en/blog/2019/04/what-is-streamlined-sales-tax-and-why-should-you-care.html>.

Impact to Small Businesses

From orthotic shoe shops; outdoor sporting goods stores; drone dealers; jewelry suppliers and dealers; to scrapbook supply sellers—businesses of different sizes and product lines have demonstrated that the *Wayfair* decision has impacted their business in three main ways. First, these businesses have experienced an exponential growth in the number of the number of states and local jurisdictions they collect sales taxes in, remit sales taxes to, and must file reports with. Second, they have all had substantially increased expenditures related to the amount of employee time, attorneys’ fees, accounting fees, bookkeeping services, and sales tax software spent on compliance with the 10,814 different sales tax jurisdictions. Third many sellers, especially those that sell on online marketplaces such as Amazon, have received unexpected sales tax notices from California, Massachusetts, and Washington state for the non-payment of state sales taxes prior to the *Wayfair* decision in 2018.

These compliance burdens have cost these businesses thousands of dollars each year. Many small businesses—such as a high-performance apparel business in Idaho—went from collecting sales tax in the state that they were physically located to collecting sales tax in 26 states.¹⁸ Another small business—an orthotic shoe shop from Michigan—provided a statement to this Subcommittee that the sales tax compliance burdens that his shop faced in 2018 and 2019 totaled \$90,000 for a business that employed 10 people.¹⁹ A third small business—a mattress retailer with 70 employees located in Michigan—provided a statement to this Subcommittee about back sales taxes assessed by the State of California from 2007 totaling \$6,179,146, even though the company does not maintain a physical presence in the state.²⁰

Policy Proposals

In his dissent in *Wayfair*, Chief Justice Roberts argued that Congress has the capacity to investigate and analyze facts beyond anything the Judiciary could match.²¹ He prescribes three lines of inquiry for Congress: 1) whether the tax revenues for states and local governments under *Wayfair* have materialized, without disruption to e-commerce, 2) weighing the benefits of additional tax revenue over foreseeable harm to e-commerce, or 3) a compromise that allows states to tax internet sales by out-of-state retailers only if revenue from such sales exceeds a threshold amount each year.

Congress also has its own ideas about how to solve this issue. Most notably are the Senate’s bipartisan Marketplace Fairness Act, S. 976, 115th Cong.²² and the House’s bipartisan Remote Transactions Parity Act, H.R. 2193, 115th Cong.—neither of which has been re-introduced in the 116th Congress. Both pieces of legislation sought to establish a fair economic nexus standard instead of a physical presence standard.

Legislation that has been introduced in the 116th Congress includes the Protecting Businesses from Burdensome Compliance Cost Act, H.R. 379, the Stop Taxing Our Potential Act, S. 128, and the Online Sales Simplicity and Small Business Relief Act, H.R. 1933. Both H.R. 379 and S. 128 propose to reinstate a physical presence requirement in order to collect sales and use tax. H.R.

¹⁸ See Appendix B – Statement of Rex Bledsoe, CEO of Aqua Design.

¹⁹ See Appendix C – Statement of Matthew Behnke, Owner of the Orthotic Shop, Inc.

²⁰ See Appendix D – Statement of Joe Nashif, President of US-Mattress.com.

²¹ 138 S. Ct. 2080 (citing *General Motors Corp. v. Tracy*, 519 U. S. 278, 309 (1997)).

²² The Marketplace Fairness Act passed the Senate in 2013 with a 69-23 vote.

1933 would create an exemption for businesses that make less than \$10 million in annual online sales.

Conclusion

As Congress moves forward to examine the issues left unresolved by the *Wayfair* decision, it should keep small, rather than mid-sized or large businesses, at the forefront of its mind. Small businesses are the lifeblood of the U.S. economy, creating two-thirds of net jobs and accounting for 44 percent of U.S. economic activity.²³ This hearing will examine how the *Wayfair* decision will continue to impose a barrier for small businesses to participate in interstate commerce, which could hinder future economic growth.

²³ SMALL BUS. ADMIN., *Small Businesses Generate 44 Percent of U.S. Economic Activity* (January 30, 2019) <https://advocacy.sba.gov/2019/01/30/small-businesses-generate-44-percent-of-u-s-economic-activity/>.