

TENNESSEE FARM BUREAU FEDERATION

2018 Policy Development



Online Sales Tax

Issue

The U.S. Supreme Court recently ruled states may require online retailers to collect sales tax. The case, *South Dakota vs. Wayfair (2018)*, changed the standard previously set by the Court in the *Quill Corp. vs. North Dakota (1992)* case which required a retailer to have a physical presence or employees in a state before the state could require collection of sales tax. Many states, including Tennessee, anticipated this ruling. In the last legislative session there was much discussion about the process and how to use the additional revenue resulting in online sales tax collections. It is estimated Tennessee loses \$450 million in revenue from online sales. What to do with additional revenue, along with changes that will need to be implemented to comply with the Court's standards for collecting sales tax will also be issues in the next legislative session.

Background

Collecting online sales tax has been an issue for state governments across the nation, especially states highly dependent on sales tax such as Tennessee. Collecting sales tax from out of state purchases is not a new issue even though online retail sales through the internet is relatively new. Purchases from catalogues and physical purchases out of state occurred before the internet. Most states have a use tax which is a counterpart to the sales tax. It is applied when something is purchased in another state and brought into Tennessee for use or consumption if the Tennessee sales tax is not paid. Forty-five states that have a sales tax law also have a use tax. From a practical standpoint, the use tax is paid based on the honor system. Many consumers do not pay this use tax from online, catalogue, or other types of sales.

The proliferation of online sales prompted a national effort called the Streamlined Sales and Use Tax Project. States across the nation started the project to simplify and modernize administration of state and local sales and use tax laws. Tennessee became involved early in the process and has been an associate member of the governing board since 2005. Tennessee passed legislation in 2007 bringing the state in compliance with the Streamlined Sales and Use Tax Agreement (SSUTA). The SSUTA implemented uniform definitions, registration of farmers in order to receive agriculture exemptions, a centralized registration system, and centralized service providers to collect out of state taxes. This legislation made numerous changes to the administrative process for collecting sales and use tax in Tennessee. The effective date of the legislation has been extended numerous times in anticipation of changes on the federal level or a court decision which would allow collection of sales and use taxes across state lines by retailers using the SSUTA. The only major provisions already in effect are the farmer registration provisions. The last change in effective date was from July 1, 2017 to July 1, 2019.

Quill Corp. vs. North Dakota (1992)

The *Quill* case involved mail order sales and whether North Dakota could require the out of state retailer to collect North Dakota's sales tax. The U.S. Supreme Court declared, "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and that the 'income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.'" This

basically required the retailer to have a physical presence inside the state in order to satisfy the law of due process. This meant the retailer must have substantial enough activities in the state to justify the fairness of a state having jurisdiction over the retailer. The Commerce Clause also came into play in this ruling. The Supreme Court believed a physical presence in the state was a “bright-line rule in the areas of sales and use taxes...”. The ruling allowed states to require collection of sales and use taxes from retailers with a physical presence such as Tennessee. For example, when Amazon built a warehouse in Tennessee, Amazon’s physical presence allowed Tennessee to require collection of taxes from Tennesseans for online sales.

South Dakota vs. Wayfair (2018)

South Dakota passed a law in 2016 that required out of state retail sellers to collect sales tax just as if the seller had a physical presence in the state. The obligation was only if the seller annually delivered more than \$100,000 of goods or services or engaged in 200 or more separate transactions to the state. This case was ultimately heard in the U.S. Supreme court where the Court held that the *Quill* case was flawed. It ruled the physical presence rule is not a necessary interpretation. Procedurally, the case was remanded which means the issue is not completely resolved. However, the court believed South Dakota’s standards of \$100,000 of goods or services or 200 or more separate transactions to the state would be constitutional. This allows states to implement similar standards as South Dakota.

Tennessee Rule 129

The Tennessee Department of Revenue changed their regulations, specifically rule 129, to require out of state dealers to begin collecting sales tax for the state of Tennessee by July 1, 2017. Tennessee’s rule 129(2) set minimum requirements much like South Dakota in order to establish a significant economic nexus between the dealer and Tennesseans. The minimum standard in rule 129 was \$500,000 in sales to Tennessee customers in a twelve-month period.

Before the rule could become effective, a suit was filed against the state called *American Catalog Mailers Association v. Tennessee Department of Revenue* based on *Quill* case. An agreed order restricted the department from implementing rule 129 until the court made a final judgement. The Tennessee legislature also became involved and passed legislation prohibiting the department from collecting sales tax under rule 129 if allowed by a court ruling. The ruling must be reviewed and approved by the General Assembly.

The *Wayfair* case changes the dynamics surrounding rule 129. It is not clear how the current court case will progress, but Tennessee’s standards are relatively in line with South Dakota’s standards. Also, the SSUTA between states will further facilitate adherence with the *Wayfair* case and allow states to take advantage of the ruling.

Other issues

Tennessee has over 400 taxing jurisdictions. Today out of state companies can choose to collect sales tax under Tennessee law by paying a flat rate sales tax of 9.25%. Under the current law, the state decides where the 2.25% from out of state sales tax is allocated. Ninety two percent of the tax collections go to city jurisdictions based on current sales tax collections in those cities. Therefore, cities with large scale retail activity receive the bulk of out of state sales tax funds allocated to local governments. If the streamlined sales tax system is allowed to become effective, this flat rate allocation would go away and the out of state business would be required to pay the local jurisdiction tax rate.

Questions

1. Do you believe Tennessee should collect sales and use tax from online and other out of state sales?
2. Should the minimum standard be reduced to the South Dakota standard?
3. Should Tennessee offset new revenues from out of state collection of taxes with tax reductions for Tennesseans?

Farm Bureau Policy

State and Local Taxes (partial)

Sales tax remains a major dependable component of revenues for local governments. Particularly for rural counties, the sales tax on staple items is a main portion of their sales tax base. We oppose the shifting of the state shared taxes away from local governments. As rural residents make purchases in urban areas, their sales tax dollars are distributed there as well. The sales tax distribution formula needs to be adjusted to allow a portion of the dollars to be allocated to the home area of the purchaser.