

OFFICE OF THE
LEGISLATIVE
FISCAL
ANALYST

JONATHAN C. BALL
DIRECTOR

MEMORANDUM FOR EXECUTIVE APPROPRIATIONS COMMITTEE

FROM: Andrea Wilko, Chief Economist

DATE: July 16, 2018

SUBJECT: Online Sales Tax Legislation

On June 21, 2018 the Supreme Court ruled that states can impose tax collection requirements on online purchases even if the seller doesn't have a physical presence (nexus) there. The decision in the case, *South Dakota v. Wayfair*, reversed a 1992 ruling in *Quill Corporation v. North Dakota* that said sellers only had to collect state sales taxes if they had a physical presence, such as a warehouse or office, in the state.

The *Wayfair* decision is not an automatic trigger for the State to collect sales tax from non-nexus sellers. In order to begin the collection process, the Legislature will have to implement a statute change requiring sellers to collect the sales tax. Under current statute, non-nexus sellers do not have to register or collect Utah sales and use tax. However, they may collect Utah sales tax voluntarily. Please refer to the attached memorandum from Andrea Valenti Arthur for a summary of the case and related issues.

Utah Code 59-12-103.1 requires the Tax Commission to report to the Revenue and Taxation Interim Committee the following upon action of the Supreme Court authorizing states to require additional sellers to collect the state's sales taxes:

- 1) The amount of state revenue collected at the time of the report; and
- 2) The estimated state sales and use tax rate reduction that would offset the amount of state revenue estimated to be collected for the current fiscal year and the next fiscal year.

The Legislative Fiscal Analyst, the Governor's Office of Management and Budget and the Tax Commission developed a consensus forecast using the *Wayfair* criteria: more than \$100,000 in sales or 200 or more separate transactions in a year. The consensus estimate is \$58.6 million in state sales tax revenue and \$25.1 million in local sales tax revenue, for a total of \$83.7 million in increased sales tax revenue. State statute contemplates that the State use this revenue to reduce the State's sales tax rates and to fund certain sales and use tax exemptions. The potential state sales tax rate reduction for revenue neutrality would be 0.113% bringing the state sales tax rate down to 4.587% from 4.7%.

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However, S.B. 233 “Sales and Use Tax Amendments,” 2018 General Session, authorized the expansion of an exemption for a manufacturing facility, certain mining operations, or a web search portal, and implements a new exemption for a medical laboratory effective upon the state collecting enough revenue to fund the exemptions via remote sales.

Under the provisions of the bill, the Division of Finance shall notify the Legislative General Counsel and the Tax Commission once the balance of the qualified state revenue collected from remote sellers, as that term is defined in Section 59-12-103.2, in the Remote Sales Restricted Account created in Section 59-12-103.2, is \$55,000,000.

If the consensus numbers of \$58.6 million in state revenue are achieved, the exemptions would go into effect, reducing the potential balance in the remote account to \$3.6 million. With a balance of \$3.6 million, the state sales tax rate could be reduced from 4.7% to 4.69%.

In 2013, the Legislature authorized non-nexus sellers who voluntarily register for the first time on or after January 1, 2014 to keep 18 percent of the Utah sales tax they collect. Sellers who take the 18 percent seller discount may not take the 1.31 percent seller discount for filing monthly. In implementing any sales tax changes for non-nexus sellers, the Legislature may want to consider eliminating the 18 percent discount since these sellers would be mandated to remit under the potential statute change.



MEMORANDUM

TO: Executive Appropriations Committee

FROM: Andrea Valenti Arthur

DATE: July 11, 2018

SUBJECT: *South Dakota v. Wayfair* decision

Below is a summary of the *South Dakota v. Wayfair* decision from the United States Supreme Court and the decision's effect on Utah law.

Summary of the *South Dakota v. Wayfair* decision

On June 21, 2018, the United States Supreme Court issued *South Dakota v. Wayfair*, a 5-4 decision that overturned the Court's 1992 decision in *Quill Corp. v. North Dakota* and 1967 decision in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*. In *Quill* and *Bellas Hess*, the Court concluded that the substantial nexus requirement of the commerce clause requires a seller to have a physical presence in the state before a state could require the seller to collect the state's sales tax on sales to the state's residents. The Court in *Wayfair* overruled the physical presence requirement, concluding that substantial nexus may be satisfied without physical presence so long as the seller "avails itself of the substantial privilege of carrying on business" in the state. (Citation and internal quotation marks omitted.) The Court did not elaborate on what constitutes a substantial nexus to authorize a state to require sales tax collection but concluded that the South Dakota law—which requires a seller to sell more than \$100,000 of goods or services into South Dakota or to make at least 200 transactions for delivery in South Dakota—established "nexus [that] is clearly sufficient based on both the economic and virtual contacts" the sellers have with the state. The Court, however, did not resolve the constitutionality of South Dakota's statute. Instead, it addressed the substantial nexus part of the commerce clause's four-part test and remanded the case to the South Dakota Supreme Court to resolve any questions remaining under the other parts of the test.

The Court noted that there are other potential commerce clause issues that it did not resolve in the decision. These issues include whether a state could subject a seller with fewer contacts with the state to the collection requirement; whether seller could be subject to retroactive collection requirements; and whether a law like South Dakota's creates undue burdens on small sellers by subjecting them to multiple compliance obligations. However, the Court indicated that South Dakota provided protections to prevent discrimination against interstate commerce and to insulate small sellers because the South Dakota law "applies a safe harbor to those who transact only limited business in South Dakota"; the South

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Dakota law “ensures that no obligation to remit the sales tax may be applied retroactively”; and South Dakota is “one of more than 20 states that have adopted the Streamlined Sales and Use Tax Agreement,” which “standardizes taxes to reduce administrative and compliance costs.” The Court also noted that Congress “may legislate to address these problems.”

Effect on Utah Law

Utah Code Section 59-12-103.1 enables the state to implement, prior to a legislative session, a decision by Congress or the United States Supreme Court, such as the *Wayfair* decision, to the “extent . . . authorized by” the federal action. Section 59-12-103.1 requires three actions to implement the Court’s decision:

1. The State Tax Commission to provide two reports to the Revenue and Taxation Interim Committee: an electronic report regarding the federal action and certain fiscal information¹ and an in-person report on this subject at the next committee meeting after the Court decision becomes effective.
2. The Revenue and Taxation Interim Committee to review the Court’s action and provide the State Tax Commission with a date on which the State Tax Commission is to begin to require sellers without a physical presence to collect the tax. The Revenue and Taxation Interim Committee must select a date that begins at the start of a calendar quarter (January 1, April 1, July 1, or October 1).
3. The Revenue and Taxation Interim Committee to provide recommendations to the Legislative Management Committee on any necessary amendments to state code because of the federal action.

¹ The State Tax Commission has provided the attached report to the committee to fulfill its statutory obligation.



State of Utah

GARY R. HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

Utah State Tax Commission

JOHN L. VALENTINE
Commission Chair

MICHAEL J. CRAGUN
Commissioner

ROBERT P. PERO
Commissioner

REBECCA L. ROCKWELL
Commissioner

BARRY C. CONOVER
Executive Director

June 21, 2018

Revenue and Taxation Interim Committee
Utah Capitol Building
350 North State Street 120 State Capitol
Salt Lake City, Utah 84114

Revenue and Taxation Interim Committee Chairs,

Utah Code §59-12-103.1 requires that the commission shall report to the Revenue and Taxation Interim Committee by electronic means addressing actions taken by the Supreme Court of the United States related to tax collection on remote sales and stating the following:

- 1.the amount of revenue collected at the time of the report; and
- 2.estimated the state sales and use tax rate reduction that would offset the amount of state revenue estimated to be collected for the current fiscal year and the next fiscal year.

On June 21, 2018 the U.S. Supreme Court issued the decision in South Dakota v. Wayfair, Inc. which held:

“. . . the Court concludes that the physical presence rule of *Quill* is unsound and incorrect. The Court’s decisions in *Quill Corp. v. North Dakota*, 504 U. S. 298 (1992), and *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U. S. 753 (1967), should be, and now are, overruled.

. . . South Dakota’s tax system includes several features that appear designed to prevent discrimination against or undue burdens upon interstate commerce. First, the Act applies a safe harbor to those who transact only limited business in South Dakota. Second, the Act ensures that no obligation to remit the sales tax may be applied retroactively. Third, South Dakota is one of more than 20 States that have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs: It requires a single, state level tax administration, uniform definitions of products and services, simplified tax rate structures, and other uniform rules. It also provides sellers access to sales tax administration software paid for by the State.

Sellers who choose to use such software are immune from audit liability. *Any remaining claims regarding the application of the Commerce Clause in the absence of Quill and Bellas Hess may be addressed in the first instance on remand.*

The judgment of the Supreme Court of South Dakota is vacated, and the case is remanded for further proceedings not inconsistent with this opinion.” (*emphasis added*)

As of June 21, 2018 the Commission has not collected any revenue as a direct result of the Supreme Court’s decision in South Dakota v. Wayfair, Inc. The Tax Commission intends to work in consultation with the Governor’s Office of Management and Budget and the Office of Legislative Fiscal Analysts to develop a consensus estimate of the state sales and use tax rate reduction that would offset the projected amount of new sales and use tax revenue resulting from the Supreme Court’s decision for the current fiscal year and the next fiscal year.

Upon receipt of this report, Utah Code §59-12-103.1 states that the Revenue and Taxation Interim Committee shall review the actions taken by the Supreme Court and direct the Commission regarding the day on which the commission is required to collect the tax.

Sincerely,



John L. Valentine, Chair

Utah State Tax Commission