

**SENATE FISCAL AGENCY
 MEMORANDUM**

DATE: June 25, 2018
TO: Members of the Senate
FROM: David Zin, Chief Economist
RE: Recent U.S. Supreme Court Decision on Sales Taxes on Internet Sales

On June 21, 2018, the U.S. Supreme Court issued a 5-4 decision in *South Dakota v. Wayfair*, a case concerning the ability of a state to require retailers with no physical presence in the state to collect sales tax on sales made to residents of that state. The decision overturned a 1992 decision, *Quill v. North Dakota*, which had prohibited states from requiring retailers without a physical presence in the state to collect sales taxes. This memorandum will provide a very brief background on the issue and outline the potential impact on Michigan tax collections.

Background

Forty-five of the 50 states levy a sales tax on the sale of selected goods and services. States vary considerably in what is included in the sales tax base. Final retail sales are taxed more often than intermediate sales (such as from a wholesaler to a retailer), and sales of goods are more likely to be taxed than services. Most states also levy a complementary use tax, designed to prevent resident taxpayers from avoiding sales tax by purchasing taxable items in another state or country. State sales tax rates vary considerably and most states also allow different types of local units to levy sales taxes.

States can reduce tax evasion and improve tax administration efficiency by having retailers collect the sales tax at the point of sale and remit it to the state. When the seller is located out of state, the state has limited authority to require the seller to collect and remit the tax. Legally, in most states, the purchaser is obligated to report and remit use tax on the purchase, but in reality it is very difficult for a State to ensure that taxpayers comply with their use tax obligations. The *Quill v. North Dakota* decision indicated that a state could not compel a seller to collect and remit sales or use tax if the seller had no physical presence in the state.

As remote sales moved from catalog sales, such as those involved in the *Quill* decision, to internet sales (or e-commerce), states experienced a significant erosion in sales and use tax revenue because they were unable to require sellers to collect taxes. As a result, states began to look to Congress to provide a remedy. When Congress failed to address the situation, the National Governor's Association and the National Conference of State Legislatures formed the Streamlined Sales Tax Project in an effort to simplify sales tax collection. The simplification of collections was designed to address one of the key arguments in *Quill*, which was that sellers would have to become familiar with more than 6,000 separate tax jurisdictions and doing so would be an unreasonable burden on a seller with no physical presence in a state.

Currently, 24 states--including Michigan--have adopted conforming legislation as part of the Streamlined Sales Tax Agreement. That legislation primarily created standardized definitions of items, which each state could then choose to tax or exempt. Under the Agreement, retailers voluntarily elect to participate and participants may take advantage of a number of processes and rules that simplify tax collection. Many states, including Michigan, also have passed additional legislation to require tax

collection on certain online sales. For example, Michigan enacted Public Acts 553 and 554 of 2014 (together often called the Michigan Main Street Fairness Act) to establish affiliate nexus for online firms that allow a state-based seller to sell through their websites. (Nexus refers to a firm's connection with a state, and is required for a state to impose tax liability on an entity.) Faced with substantial pressure to collect sales taxes, many larger online sellers voluntarily now collect sales taxes--including 19 of the 20 largest online retailers, depending on the data examined. The Michigan Department of Treasury's Office of Revenue and Tax Analysis estimates that under current law, the revenue loss under e-commerce and mail-order sales is still approximately \$468.1 million per year, although a portion of that figure includes business-to-business sales.

What the Decision Means for Michigan

In the short run, the *Wayfair* decision potentially will have a limited impact on Michigan. As indicated, Michigan already participates in the Streamlined Sales Tax Agreement, and has enacted supplementary legislation to ensure that a number of other online sales are subjected to tax. Furthermore, many of the larger online sellers already remit tax to the State. As a result, the decision is unlikely to significantly change the number of existing sellers that are remitting sales and use tax revenue to the State, especially given that Michigan statute does not currently impose nexus on many of these sellers. Michigan now does possess the authority, through new legislation or revenue rulings, to use the *Wayfair* decision to expand nexus, although the amount of revenue that could be raised would depend on many factors--including the size of any potential small seller exemption.

Arguments before the *Wayfair* Court suggested that taxpayers presently could face as many as 12,000 different taxing jurisdictions. As a result, the decision may either increase the number of sellers that participate in the Streamlined Sales Tax Agreement and/or increase the chance that Congress will adopt legislation addressing the situation. Congressional legislation could take a number of different approaches, and many of these approaches have been introduced in current, or earlier, sessions of Congress. These approaches range from allowing states to impose nexus on sellers that do not have a physical presence, to requiring online sellers and/or states to join the Agreement, to requiring a seller to have physical presence before a state may require it to collect taxes (essentially establishing the *Quill* decision as statutory law). As mentioned earlier, the *Wayfair* decision may cause states, including Michigan, to consider changes to their nexus requirements.

To the extent that participation in the Streamlined Sales Tax Agreement increases, that Congress adopts legislation consistent with the *Wayfair* decision, or that Michigan broadens its nexus standards, sales and use tax revenue to the State could increase by an unknown amount. Conversely, if Congress were to enact legislation imposing physical presence as a requirement before a state could require tax collection, sales and use tax collections could remain unchanged--or perhaps decline, as retailers decided they no longer needed to collect taxes.

The Senate Fiscal Agency will continue to monitor how states and the Federal government respond to the *Wayfair* decision, as well as continue to track how consistent collections are consistent with forecasted levels.

If you have any questions, please contact me at 32768.

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cc: Ellen Jeffries, Director
Kathryn Summers, Associate Director
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