What you need to know

Sales Tax and Interstate Commerce

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Sales Tax and Interstate Commerce

For the majority of states in the U.S., sales tax is a substantial part of their overall revenues. Some have only a state-wide sales tax, while many allow local governments to set their own additional rates. This historically important source of revenue has become a major cause of concern over the past few years with the continued growth of interstate sales.

Sales Tax History and Nexus

The Supreme Court ruled, in 1977, that the potential taxpayer (seller) must have "substantial nexus" with the state in order for the state to impose its tax. This ruling was confirmed in the notable case Quill Corp. vs. North Dakota (1992). In the Quill case, the Supreme Court struck down North Dakota's attempt to force Quill to collect sales tax on shipments into the state. Although the court confirmed Quill had no nexus in North Dakota and therefore no tax liability, it did explicitly state that Congress can overrule the decision through legislation.

FAST FACTS

- The first broad-based, general sales taxes in the United States were enacted by Kentucky and Mississippi in 1930.
- 5 states (Alaska, Delaware, Montana, New Hampshire and Oregon) do not levy a statewide sales tax.
- Estimated lost sales tax from interstate internet and mail transactions is over $13 billion annually.

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Nexus generally means physical presence in a state. A small seller would typically have physical presence in only one state, thus only have to collect sales tax for orders shipping within that state. A larger seller may have distribution centers or sales offices in addition to its headquarters, thus would collect sales tax for orders shipping to those specific states. This leaves a large portion of sales shipped to states where the seller does not have physical presence nexus, thus there is often no requirement to collect the sales tax due.

Sales Tax vs. Use Tax

The lack of nexus shifts the burden of tax from the seller (collected) to the consumer (paid); a use tax. Use tax applies to transactions that are subject to tax, but not taxed at the point of sale. Consumers are legally obligated to remit use taxes on non-taxed purchases.

With state budgets tight, over half of U.S. states added a line item on their individual returns in an attempt to collect more use tax. The taxpayer is required to report all non-taxed purchases and voluntarily remit the owed taxes. Some states include a table taxpayers can use to quickly estimate non-taxed purchases based on income levels. Unfortunately, from a revenue collection standpoint, less than 1% of taxpayers reportedly fill out this line.

FYI

With things always changing, be sure to talk with Reilly, Penner & Benton for help with sales tax challenges.

Impact on States

Currently the estimate of lost sales tax across all states from non-taxed internet and mail transactions is over $13 billion annually. With an increasing number of state budget shortfalls, many states are attempting to enact legislation to recover this lost revenue. As of January 2017, there were 35 bills pending in 17 states.

The details differ, but most of the bills have the common goal of redefining nexus, moving away from the traditional bricks and mortar physical presence and instead adopting an “economic nexus” approach. This approach would use sales dollars or numbers of transactions (or both) to determine state nexus and the requirement to collect sales tax. Some bills push a softer approach, until nexus is redefined, by encouraging individual taxpayers to start reporting these transactions on their tax forms. Some proposed bills would require sellers to notify their customers of this responsibility, usually with a letter, and also recap their annual purchases to make it easier for them to report.

The state of Wisconsin has a good example of this overall initiative. Wisconsin SB 259, introduced 5-17-2017, would require non-nexus sellers to provide an annual itemized statement (by Jan 31) to each Wisconsin customer listing their purchases from the previous year. This rule would apply to any shipper with over $50,000 yearly sales in the state. An alternative for the seller, instead of notifying each customer, would be to remit a summary statement to the Department of Revenue including the names and addresses of all Wisconsin customers and the amount of their purchases.

Federal initiatives

Although sales taxation is a state issue, the Federal government has recognized that states have limited ability to fix this situation. Many governors support action by Congress to correct this issue and help states recover sales tax revenues they have been losing from interstate sales.

In 2013 Congress passed the Marketplace Fairness Act. This act would give states the ability to force sellers to collect and remit sales tax for all transactions, regardless of nexus status. To help implementation, it simultaneously forces states to simplify their state and local taxation rates so the process is not too burdensome for the sellers. Despite passing Congress with strong bipartisan support, the bill is still in the House of Representatives and has not reached the floor for a vote.

Contact our Tax team at

414.271.7800 with any questions