

SUPREME COURT OF NORTH CAROLINA

QUAD GRAPHICS, INC.,

Petitioner-Appellee

v.

NORTH CAROLINA
DEPARTMENT OF REVENUE,

Respondent-Appellant

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From Wake County

BRIEF OF AMICUS CURIAE MULTISTATE TAX COMMISSION

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ARGUMENT¹

Quad Graphics, Inc. (“Quad Graphics”) relies on *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327 (1944) to argue that the sales tax assessment on its sales of printed material is invalid. We write to explain that *Dilworth* is not controlling.

¹ No person or entity, other than the MTC and its counsel, directly or indirectly, wrote this brief in whole or in part. Only the MTC and its member states, through the payment of their membership fees, made any monetary contribution to the preparation or submission of this brief.

I. *COMPLETE AUTO* EXPRESSLY OVERRULED THE “FREE TRADE” RULE, IMPLICITLY OVERRULING *DILWORTH’S* RELIANCE ON THAT RULE

The United States Supreme Court has recognized that its earlier but not expressly overruled decisions construing state taxing authority may “no longer fully represent the present state of the law.” *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959) (citation omitted). A prior decision is implicitly overruled if based on an analytical framework that is no longer valid. *Indiana-Kentucky Elec. Corp. v. Ind. Dep’t of Revenue*, 598 N.E.2d 647, 654–55 (Ind. T. C. 1992) (determining that an earlier Indiana Supreme Court decision was implicitly overruled by *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)).

At the time *Dilworth* was decided, the Court deemed interstate commerce entirely immune from state taxation under the Commerce Clause, U.S. Const., Art I, § 8, cl. 3: “The very purpose of the Commerce Clause was to create an area of free trade among the several States.” 322 U.S. at 330. Under this “free trade” rule, commerce clause analysis involved merely determining if a tax applied to transactions in interstate commerce. If so, the tax violated the commerce clause, and the inquiry

ended without considering any other factors. A tax did not violate the commerce clause if it applied to a “local incident.”

Where a corporation chooses to stay at home in all respects except to send abroad advertising or drummers to solicit orders which are sent directly to the home office for acceptance, filling, and delivery back to the buyer, it is obvious that the State of the buyer has no local grip on the seller. Unless some local incident occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable.

Norton Co. v. Dep’t of Revenue of Ill., 340 U.S. 534, 537 (1951) (citing *Dilworth*).

This analytical framework required courts to draw a line between local and interstate activities, as shown by comparing *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940) (upholding a New York City sales tax on a Pennsylvania manufacturer’s sales of coal it delivered to customers in the city) to *Dilworth* (invalidating Arkansas sales tax on a Tennessee seller’s sales of product delivered by common carrier to Arkansas customers).

In *Berwind-White*, New York City imposed sales tax on “purchasers for consumption of tangible personal property,” to be collected by the seller. 309 U.S. at 42. Although the manufacturer transported the coal from Pennsylvania to the city, the Court viewed the tax as imposed on

the local activity of “delivery of goods within the state upon their purchase for consumption,” and considered it indistinguishable from a use tax. *Id.* at 58.

Its only relation to the commerce arises from the fact that immediately preceding transfer of possession to the purchaser within the state, which is the taxable event regardless of the time and place of passing title, the merchandise has been transported in interstate commerce and brought to its journey’s end. Such a tax has no different effect upon interstate commerce than a tax on the “use” of property which has just been moved in interstate commerce.

Id. at 49.

The Court viewed the sales transactions as consummated upon delivery of the coal to the purchaser within the city, pursuant to the sales tax imposition law, which sourced the sales transactions to that location: “[T]he object of interstate shipment is a sale at destination [T]he tax is conditioned upon a local activity, delivery of goods within the state upon their purchase for consumption.” *Id.* at 54, 58. The Court could see no difference between the destination-sourced sales tax at issue and a use tax: “[W]e can find no adequate basis for distinguishing the present tax laid on the sale or purchase of goods upon their arrival at destination at the end of an interstate journey from the tax which may be laid in like

fashion on the property itself.” *Id.* at 52.

In contrast, the *Dilworth* majority opinion, relying on the Arkansas Supreme Court’s interpretation of Arkansas law, viewed the sales transactions at issue as interstate commerce and consummated in Tennessee: “For Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction.” 322 U.S. at 330. The *Dilworth* majority acknowledged that Arkansas could have imposed a use tax collection duty on the seller, making the formalistic distinction between a sales tax on an interstate sale, which violated the free trade rule, and a use tax, which did not. *Id.* at 330–31.²

In his *Dilworth* dissent (joined by two other justices), Justice Douglas echoed *Berwind-White* in finding no substantive difference between the destination state’s sales tax on an interstate sale and seller-collected use tax, stating that there should be no different result under

² *Henneford v. Silas Mason Co.*, 300 U.S. 577, 582 (1937), which preceded *Dilworth*, held the use tax constitutional, “not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end.” That decision considered the use tax to be a separate tax complementary to the sales tax and imposed on the local activity of using the purchased item in the taxing state when no sales tax was paid. *Id.* at 580-81. This avoided the free trade rule’s absolute bar against imposing tax on interstate transactions.

the commerce clause.

But a use tax and a sales tax applied at the very end of an interstate transaction have precisely the same economic incidence. Their effect on interstate commerce is identical.

Id. at 333. He recognized the destination state's power to tax an interstate sale: "In terms of state power, receipt of goods within the State of the buyer is as adequate a basis for the exercise of the taxing power as use within the State." *Id.* at 334.

Justice Rutledge dissented separately,³ comparing *Dilworth* to *General Trading Co. v. State Tax Comm'n of Iowa*, 322 U.S. 355 (1944), a companion decision, which upheld Iowa's authority to impose a use tax collection duty on an out-of-state seller with sales representatives in the state. Viewing the Iowa use tax in *General Trading* and the Arkansas sales tax in *Dilworth* as operating under "identical material circumstances," each tax with a "due process connection with the transaction" and neither tax burdening interstate commerce, Justice Rutledge concluded that "it is hard to see how one tax can be upheld and the other voided." 322 U.S. at 351. He strongly criticized the *Dilworth*

³ Published with *Int'l Harvester Co. v. Dep't of Treasury*, 322 U.S. 340, 349 (1944).

majority's reliance on a technicality, title transferring to the buyer upon delivery to the common carrier: "Surely the state's power to tax is not to turn on the technical legal effect . . . that 'title passes' on delivery to the carrier in Memphis." *Id.* He stated further: "Other things being the same, constitutionality should not turn on whether one name [for the tax] or the other is applied by the state." *Id.* at 352.

Like Justice Douglas, Justice Rutledge also found sufficient connections with Arkansas, the destination and market state, to sustain the tax:

[T]he goods are sold and shipped to Arkansas buyers. Arkansas is the consuming state, the market these goods seek and find. They find it by virtue of a continuous course of solicitation there by the Tennessee seller.

Id. at 353–54.

Anticipating the future demise of the free trade rule, both *Dilworth* dissents identified the major flaw in the majority opinion's reliance on that rule to invalidate the Arkansas tax. The decision rested on a formalism, the artificial distinction between a destination state's imposition of a sales tax on an interstate sale and a seller-collected use tax—while completely ignoring the factors showing a strong connection

between Arkansas and the Tennessee seller: the seller's representatives solicited the sales in Arkansas, the market state, where the purchased goods were delivered for consumption.

Two years after *Dilworth, Freeman v. Hewit*, 329 U.S. 249 (1946) relied on the free trade rule to invalidate Indiana's gross receipts tax on an Indiana trustee's proceeds received from the sale of the trust's stocks on the New York Stock Exchange. The trustee's broker mailed certificates from Indiana to New York and received the proceeds by mail. The Supreme Court determined that the tax was imposed on an interstate sale and interfered "with the free flow of commerce." *Id.* at 256-57. The Court noted the precedent for states lawfully imposing consumption taxes on goods coming from out-of-state but distinguished the permissible "local" sales tax in *Berwind-White* from the impermissible direct sales tax on interstate commerce in *Dilworth*: "Taxes which have the same effect as consumption taxes are properly differentiated from a direct imposition on interstate commerce." *Id.* at 257. *Freeman's* "blanket prohibition against any state taxation imposed directly on an interstate transaction" was viewed by commentators as the "triumph of formalism

over substance,” a criticism the Court seemed to share. *Complete Auto*, 430 U.S. at 280-81 (citations omitted).

In the free trade rule’s finale, the Court held that Connecticut’s corporate income tax violated the commerce clause when imposed on an interstate trucking company that hauled product into and out of the state. *Spector Motor Serv., Inc. v. O’Connor*, 340 U.S. 602 (1951). While acknowledging that a state may impose a tax “as compensation for petitioner’s use of the highways,” the Court—relying on both *Freeman* and *Dilworth*—determined that the tax violated the free trade rule because it was placed on the “corporation’s franchise for the privilege of carrying on exclusively interstate transportation in the State.” *Id.* at 608.

In its landmark decision, the Court in *Complete Auto* finally rejected the free trade rule by expressly overruling *Spector*, replacing that rule with the four-part test that courts follow today.⁴ A tax will be sustained if it: (1) applies to an activity that has substantial nexus with the state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services the state

⁴ Noting that the modern origin of the rejected *Spector* rule was found in *Freeman*, 430 U.S. at 279, the Court observed that elements of its views “were evident in prior opinions.” *Complete Auto* at 289, n. 9. *Dilworth* is certainly a prominent example of such a prior opinion.

provided. 430 U.S. at 279. The Court moved “toward a standard of permissibility of state taxation based upon its actual effect rather than its legal terminology” while unanimously rejecting the “proposition that interstate commerce is immune from state taxation.” *Id.* at 281, 288.

Complete Auto faulted the free trade rule for deeming “irrelevant any consideration of the practical effect of the tax” and “having no relationship to economic realities.” *Id.* at 278-79. The Court criticized *Freeman*’s use of the rule in deeming “unnecessary . . . any showing of discrimination against interstate commerce or error in apportionment of the tax,” two of the factors in the four-part test. *Id.* at 280 (citation omitted). *Complete Auto* identified the primary flaw in the “free trade” rule: it did not require consideration of any of the four factors. *Id.* at 277-78.

Decisions after *Complete Auto* have echoed rejection of the formalistic free trade rule and instead followed the four-part test. In *D. H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988) (applying *Complete Auto* and upholding Louisiana’s imposition of use tax on catalogs mailed from out of state to in-state recipients), the Court stated: “*Complete Auto* abandoned the abstract notion that interstate commerce ‘itself’ cannot be

taxed by the States.” In *Quill Corp. v. North Dakota*, 504 U.S. 298, 309-10 (1992), the Court stated that *Complete Auto* “renounced the *Freeman* approach” and overruled its progeny, *Spector*; accord, *Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 183 (1995) (applying the four-part test to uphold Oklahoma’s sales tax on the ticket price for interstate bus travel).⁵ *Wayfair* recognized *Complete Auto* as holding that “a State may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the Commerce Clause.” *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2091 (2018) (citation omitted).

Complete Auto’s rejection of the free trade rule eliminated any need to distinguish between a destination state’s sales tax imposed on an interstate sales transaction and a seller-collected use tax, making unnecessary the determination of the arbitrary point where interstate commerce ended and local activity began. The Court rendered the *Dilworth* formalism irrelevant.

The Department’s sales tax assessment satisfies the four-part test. Quad Graphics’ sales representative solicited customers in North

⁵ *Jefferson Lines* cited *Dilworth* as support for its conclusion that Oklahoma’s sales tax imposed on an interstate bus ride ticket originating in that state need not be apportioned, without considering the validity of the long-rejected free trade rule analytical framework on which *Dilworth* rested. 514 U.S. at 187.

Carolina for printed material orders (R pp 113, 948, 951, 960, 968), establishing “substantial nexus.” Quad Graphics acknowledges physical presence nexus but claims there is no nexus with the transactions at issue. (R pp 115-16, 356, 369, 969). Yet Quad Graphics’ representative’s sales solicitation activities conducted in North Carolina established nexus with those transactions, providing a direct connection to Quad Graphics’ sales of printed materials delivered to mailing addresses there.

The remaining three parts of the *Complete Auto* test are also satisfied here. North Carolina’s laws sourcing the printed material sales transactions to the recipients’ mailing addresses eliminated any risk of multiple taxation or discrimination against interstate commerce because only one location, the mailing address, meets that criterion. N.C.G.S. §§ 105-164.4B(a)(2), 105-164.4B(d)(2)(b). Quad Graphics has a strong connection to North Carolina, the market state, through its sales of printed materials delivered to North Carolina mailing addresses. Quad Graphics sought and received benefits from North Carolina through distribution of the printed material to North Carolina recipients, which grew Quad Graphics’ market there.

II. NORTH CAROLINA'S SALES SOURCING LAWS FACTUALLY DISTINGUISH *DILWORTH*

North Carolina has enacted specific statutes providing that sales of printed material for sales tax purposes occur at the recipients' mailing addresses. The Department applied those statutes in assessing sales tax on Quad Graphics' sales of printed material. These facts distinguish *Dilworth* because in that case, the Arkansas Supreme Court determined that the sales transactions at issue were completed in Tennessee. 322 U.S. at 328. Arkansas had no legislatively enacted sales sourcing statutes in place at the time. The buyer and seller agreed that title and possession transferred to the purchaser when the purchased item was placed in the hands of the common carrier, which occurred in Tennessee. *Id.* Unlike North Carolina's statutes, there was no Arkansas sourcing statute in place that would override such an agreement.

North Carolina is one of twenty-four states in the Streamlined Sales and Use Tax Agreement ("Agreement"),⁶ the purpose of which is "to simplify and modernize sales and use tax administration" to

⁶The Agreement may be accessed at https://www.streamlinedsalestax.org/docs/default-ource/agreement/ssuta/ssuta-as-amended-through-2021-5-20.pdf?sfvrsn=66137900_4 (last visited Dec. 14, 2021).

“substantially reduce the burden of tax compliance.” Agreement, Section 102.⁷ The Agreement requires member states to adopt uniform sales sourcing rules for all taxable transactions. *Id.* Uniform sales sourcing rules not only resolve confusion for remote sellers as to which state’s tax should be collected; they also eliminate the risk of multiple taxation by sourcing transactions the same way—to the destination. The Agreement’s sales sourcing rules include the general destination sales sourcing rules contained in Section 310,⁸ and specific sales sourcing rules for “direct mail” contained in Section 313.⁹

North Carolina’s general sales sourcing rules¹⁰ are consistent with Section 310, stating:

When a purchaser or purchaser’s donee receives an item at a location specified by the purchaser and the location is not a business location of the seller, the sale is sourced to the location where the purchaser or the purchaser’s donee receives the item.

North Carolina’s direct mail sales sourcing rules¹¹ are consistent with Section 313 and state that the sale of direct mail is “sourced to the

⁷ App. 12.

⁸ App. 13-16.

⁹ App. 17-20.

¹⁰N.C.G.S. § 105-164.4B(a)(2) (2009).

¹¹N.C.G.S. § 105-164.4B(d)(2)(b) (2009).

location where the property is delivered” when “the purchaser provides the seller with information to show the jurisdictions to which the direct mail is to be delivered.” Quad Graphics’ purchasers provided that information. (R. pp. 979-80).

The printing industry and states participating in the Streamlined Sales Tax Project (which preceded the Agreement) helped develop the direct mail sales sourcing rules, as described in the Issue Paper.¹² Section 313 contains those rules, which were recommended in the Issue Paper, and strongly supported by the printing industry.¹³

In *Wayfair*, the Court spoke favorably of the simplification features of the Agreement and their effectiveness in reducing the compliance burden on remote sellers. 138 S. Ct. at 2099-2100. Wisconsin, which is a member state and the location of Quad Graphics’ headquarters, adopted the destination sales sourcing provisions in Sections 310 and 313,¹⁴ as

¹² See Issue Paper entitled “Streamlined Sales Tax Project—Sourcing Direct Mail,” October 31, 2002, published in the Streamlined Sales Tax Library at https://www.streamlinedsalestax.org/docs/default-source/issue-papers/direct-mail.pdf?sfvrsn=be4de169_6 (last visited Dec. 14, 2021) (App. 21-34).

¹³ See letter dated Nov 6, 2002 from Benjamin Y. Cooper, Executive Vice President/Public Affairs, Printing industries of America, Inc., at end of Appendices to the Issue Paper (App. 33-34).

¹⁴ See WIS. STAT. § 77.522(1)(b) and (c) (2021) (App. 8-10).

has Arkansas, the state that imposed the tax at issue in *Dilworth*.¹⁵ Distinguished law professors with well recognized state and local tax expertise have suggested that member states in the Agreement “should therefore not have a problem” with the *Dilworth* formalism.¹⁶

Contrary to when *Dilworth* was decided, legislatively adopted destination sourcing laws in North Carolina determine where an interstate sale takes place for sales tax purposes—subject to the *Complete Auto* four-part test. “When a consumer purchases goods . . . , the consumer’s State often imposes a sales tax.” *Wayfair*, 138 S. Ct. at 2087.

The parties to an interstate sales transaction can negotiate where title transfers and which party bears the risk of loss on the shipped item during common carrier transit. That contractual agreement does not dictate where the sale is deemed to take place for sales tax purposes under North Carolina’s sales sourcing laws. Subsections 105-164.8(a) (3) and (6) expressly provide that, notwithstanding delivery of the property to a common carrier f.o.b. outside the state, the retailer is required to

¹⁵ See ARK. CODE ANN. §§ 26-52-521, 26-52-522 (2021) (App. 1-6).

¹⁶ See Adam Thimmesch, Darien Shanske, David Gamage, *Wayfair: Sales Tax Formalism and Income Tax Nexus*, 89 STATE TAX NOTES 975, 976 (2018) (R. pp. 409, 410).

collect North Carolina sales tax if the item is intended for storage, use or consumption in North Carolina. As distinguished from *Dilworth*, the sales at issue here are sourced to the locations where the printed material was delivered in North Carolina based on the addresses provided to Quad Graphics by its purchasers. N.C.G.S. §§ 105-164.4B(a)(2), 105-164.4B(d)(2)(b) (2009).

III. THE *DILWORTH* FORMALISM THWARTS STATES' EFFORTS TO SIMPLIFY THEIR SALES AND USE TAX STRUCTURES

States that impose sales tax have also enacted use tax as a separate complementary tax, in conformity with *Henneford*, 300 U.S. at 581. After *Complete Auto*'s rejection of the free trade rule, states have the option of simplifying their tax systems by merging destination-sourced sales tax with seller-collected use tax.¹⁷ South Dakota accomplished this objective with its remote seller sales tax collection requirement¹⁸ at issue in *Wayfair*. This merger eliminates seller-collected use tax and an out-of-state sellers' potential confusion over which tax type to collect on sales of

¹⁷ See John A. Swain, *The Sales and Use Tax Dichotomy and the Streamlining Movement*, 43 STATE TAX NOTES 129, 132 (2006); *The Zombie Precedent: Norton v. Department of Revenue*, 84 STATE TAX NOTES 301 (2017) (App. 48-58).

¹⁸ S.D. Codified Laws § 10-64-2 (2021) (App. 7). See *Wayfair*, 138 S. Ct. at 2089.

items shipped to another state.¹⁹ The out-of-state seller will always collect the destination state's sales tax on its sales of items shipped to that state.

A ruling against the Department's assessment based on the *Dilworth* formalism, assuming such a decision would be followed by other state courts, will thwart states' efforts to simplify their tax structures by merging these two tax types and set a "trap for the unwary [drafter]." *Complete Auto*, 430 U.S. at 279. The validity of the tax will depend solely on its label. State tax structures will be forced to preserve the artificial distinction between destination-sourced sales tax and seller-collected use tax, as well as the confusion as to which tax type should be collected.

The discredited *Dilworth* formalism would also dictate that states like North Carolina cannot adopt uniform destination sales sourcing laws for interstate printed material sales transactions, as provided in the Agreement, if the buyer and seller have agreed that title or possession of the purchased item transfers to the buyer upon the seller's deposit of the printed material with a common carrier. A confusing exception will exist,

¹⁹ See Richard L. Cram, *No More Dilworth Formalism After Wayfair*, 95 TAX NOTES STATE 745 (2020) (App. 35-47).

requiring the sale to be deemed to take place at the seller's location—assuming the printed material is deposited with the common carrier at the seller's location—no matter where the common carrier delivers the printed material, and without regard to the state's laws sourcing the sale to that delivery location. Such agreements should not override the North Carolina legislature's determination that for sales tax purposes, sales of printed material are sourced to the delivery addresses in North Carolina: the location where those items are consumed.

Respectfully submitted, this 20th day of January, 2022.

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CERTIFICATE OF WORD COUNT COMPLIANCE

Pursuant to Rule 28(j) of the North Carolina Rules of Appellate Procedure, I hereby certify that the foregoing brief, which was prepared using a 14-point proportionally spaced font with serifs, is less than 3,750 words (excluding covers, captions, indexes, tables of authorities, counsel's signature block, certificates of service, this certificate of compliance, and appendixes) as reported by the word-processing software.

This 20th day of January, 2022.

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CERTIFICATE OF SERVICE

I hereby certify that I have electronically filed the foregoing document with the N.C. Supreme Court using the court's electronic filing system and served the same upon the other parties to this action via E-Mail pursuant to Rule 26 of the Rules of Appellate Procedure, properly addressed to the attorneys for record as listed below:

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Title 26. Taxation

Subtitle 5. State Taxes (§§ 26-50-101 to 26-65-108)

Chapter 52. Gross Receipts Tax (§§ 26-52-101 to 26-52-1601 - 26-52-1602)

Subchapter 5. Returns and Remittance of Tax (§§ 26-52-501 to 26-52-523)

Section 26-52-521. Sourcing of sales

(a)

(1) This section applies for purposes of determining a seller's obligation to pay or collect and remit a sales or use tax with respect to the seller's retail sale of a product or service.

(2) This section does not affect the obligation of a purchaser or lessee to remit tax on the use of the product or service to the taxing jurisdictions of that use and does not apply to the sales or use taxes levied on the retail sale excluding lease or rental, of motor vehicles, trailers, or semitrailers that require licensing.

(b) Excluding a lease or rental, the retail sale of a product or service shall be sourced as follows:

(1) If the product or service is received by the purchaser at a business location of the seller, the sale is sourced to that business location;

(2) If the product or service is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser or the purchaser's designated donee occurs, including the location indicated by instructions for delivery to the purchaser or donee known to the seller;

(3) If subdivisions (b)(1) and (2) of this section do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith;

(4) If subdivisions (b)(1)-(3) of this section do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available if the use of this address does not constitute bad faith; or

(5) If none of the previous rules of subdivisions (b)(1)-(4) of this section apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, the location will be determined by the address from which tangible personal property was shipped, from which the specified digital products or the digital code was first available for transmission by the seller, or from which the service was provided, disregarding for these purposes any location that merely provided the digital transfer of the product sold.

(c) The lease or rental of tangible personal property, specified digital products, or a digital code other than property identified in subsection (d) or subsection (e) of this section shall be sourced as follows:

(1)

(A) For a lease or rental that requires recurring periodic payments, the first periodic payment is sourced the same as a retail sale in accordance with the provisions of subsection (b) of this section.

(B) Periodic payments made after the first payment are sourced to the primary property location for each period covered by the payment.

- (C) The primary property location shall be as indicated by an address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business if use of this address does not constitute bad faith.
 - (D) The property location shall not be altered by intermittent use at different locations such as use of business property that accompanies employees on business trips and service calls;
- (2) For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the provisions of subsection (b) of this section; and
- (3) This subsection does not affect the imposition or computation of sales or use tax on leases or rentals based on a lump-sum or accelerated basis or on the acquisition of property for lease.
- (d) The lease or rental of motor vehicles, trailers, semitrailers, or aircraft that do not qualify as transportation equipment as defined in subsection (e) of this section shall be sourced as follows:
- (1)
 - (A) For a lease or rental that requires recurring periodic payments, each periodic payment is sourced to the primary property location.
 - (B) The primary property location shall be as indicated by an address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business if use of this address does not constitute bad faith.
 - (C) This location shall not be altered by intermittent use at different locations;
 - (2) For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the provisions of subsection (b) of this section; and
 - (3) This subsection does not affect the imposition or computation of sales or use tax on leases or rentals based on a lump sum or accelerated basis or on the acquisition of property for lease.
- (e)
- (1) Including a lease or rental, the retail sale of transportation equipment shall be sourced the same as a retail sale in accordance with the provisions of subsection (b) of this section, notwithstanding the exclusion of a lease or rental in subsection (b) of this section.
 - (2) As used in this section, "transportation equipment" means any of the following:
 - (A) Locomotives and railcars that are utilized for the carriage of persons or property in interstate commerce;
 - (B) Trucks and truck tractors with a gross vehicle weight rating of ten thousand one pounds (10,001 lbs.) or greater, trailers, semitrailers, or passenger buses that are:
 - (i) Registered through the International Registration Plan, Inc.; and
 - (ii) Operated under authority of a carrier authorized and certificated by the United States Department of Transportation or another federal authority to engage in the carriage of persons or property in interstate commerce;

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- (C) Aircraft that are operated by air carriers authorized and certificated by the United States Department of Transportation or another federal or a foreign authority to engage in the carriage of persons or property in interstate or foreign commerce; or
 - (D) Containers designed for use on and component parts attached or secured on the items under subdivision (e)(1) of this section and this subdivision (e)(2).
- (f) As used in subsection (b) of this section:
- (1) "Receive" and "receipt" mean:
 - (A) Taking possession of tangible personal property, specified digital products, or a digital code; or
 - (B) Making first use of services; and
 - (2) "Receive" and "receipt" do not include possession by a shipping company on behalf of the purchaser.
- (g) When a motor vehicle, trailer, or semitrailer that requires licensing is sold to a person who resides in Arkansas, the sale is sourced to the residence of the purchaser.
- (h) This section shall apply to all state and local taxes administered by the Department of Finance and Administration.
- (i) The destination sourcing rules in this section do not apply to florists.

Amended by *Act 2017, No. 141, §§ 39-41*, eff. for tax years beginning on and after 1/1/2018. Acts 2003, No. 1273, § 11; 2007, No. 860, § 1; 2009, No. 384, § 8.

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Subchapter 5. Returns and Remittance of Tax (§§ 26-52-501 to 26-52-523)

Section 26-52-522. Direct mail sourcing

(a) As used in this section:

(1) "Advertising and promotional direct mail" means direct mail in which the primary purpose is to attract attention to a product, person, business, or organization or to attempt to sell, popularize, or secure financial support for a product, person, business, or organization;

(2) "Direct mail form" means:

(A) A Streamlined Sales and Use Tax Agreement certificate of exemption claiming direct mail, as in effect on January 1, 2011; or

(B) A written statement approved, authorized, or accepted by the state;

(3)

(A) "Jurisdictional information" means information sufficient for the seller to source the sale of taxable printing services resulting in advertising and promotional direct mail to the state and local jurisdictions in which the printed materials are delivered or distributed to recipients.

(B) Jurisdictional information must be in a form in which the information can be retained and retrieved by the seller for the purpose of sales and use tax reporting.

(C) Access to a database that contains address information or a mailing list provided by the purchaser or a third party that does not allow the seller to retain and retrieve the jurisdictional information identifying jurisdictions where the advertising and promotional direct mail was delivered does not constitute receiving information showing the jurisdictions to which the advertising and promotional direct mail is delivered;

(4)

(A) "Other direct mail" means any direct mail that is not advertising and promotional direct mail regardless of whether advertising and promotional direct mail is included in the same mailing and includes without limitation:

(i) Transactional direct mail that contains personal information specific to the addressee, including without limitation invoices, bills, statements of account, and payroll advices;

(ii) Any legally required mailings, including without limitation privacy notices, tax reports, and stockholder reports; and

(iii) Other nonpromotional direct mail delivered to existing or former shareholders, customers, employees, or agents, including without limitation newsletters and informational pieces.

(B) "Other direct mail" does not include the development of billing information or the provision of any data processing service that is more than incidental; and

(5) "Product" means tangible personal property, specified digital products, a digital code, a product transferred electronically, or a service.

(b) The sale of a taxable printing service resulting in the production and distribution of advertising and promotional direct mail or other direct mail shall be sourced in accordance with this section.

(c)

(1) The seller shall source the sale of taxable printing service resulting in the production and distribution of advertising and promotional direct mail according to § 26-52-521(b)(5), unless the purchaser provides the seller with a direct pay permit, direct pay form, exemption certificate, or jurisdictional information.

(2) If the purchaser provides jurisdictional information to the seller, then the seller shall source the sale of the taxable printing service to the jurisdictions to which the advertising and promotional direct mail is to be delivered.

(d) The seller shall source the sale of taxable printing services resulting in the production and distribution of other direct mail according to § 26-52-521(b)(3), unless the purchaser provides the seller with a direct pay permit, direct pay form, or exemption certificate.

(e) When both advertising and promotional direct mail and other direct mail are combined in a single mailing, the sale is sourced as other direct mail.

(f) If a bundled transaction includes advertising and promotional direct mail, this section applies only if the primary purpose of the transaction is the sale of products or services that meet the definition of advertising and promotional direct mail.

(g)

(1) In the absence of bad faith, the seller is relieved of any further obligation to collect any additional sales or use tax on the sale of advertising and promotional direct mail where the seller has sourced the sale according to the jurisdictional information provided by the purchaser.

(2) In the absence of bad faith, the seller is relieved of all obligations to collect, pay, or remit sales or use tax if the purchaser provides the seller with a direct pay permit, direct pay form, or exemption certificate.

(h)

(1) If the purchaser provides the seller with a direct pay permit, direct pay form, or exemption certificate, then the purchaser shall source the sale to the jurisdictions to which the advertising and promotional direct mail or other direct mail is to be delivered to the recipients and shall report and pay any applicable sales or use tax due.

(2) Purchasers may use a reasonable summary or allocation of the distribution to the jurisdictions to which the advertising and promotional direct mail or other direct mail is delivered for the purposes of self-assessing and directly paying sales or use tax.

(3) This section does not limit any purchaser's:

(A) Obligation for sales or use tax to any state to which the direct mail is delivered;

(B) Right under local, state, federal, or constitutional law to a credit for sales or use taxes legally due and paid to other jurisdictions; or

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Arkansas Code, A.C.A. § 26-52-522, Direct mail sourcing

(C) Right to a refund of sales or use taxes overpaid to any jurisdiction.

Amended by *Act 2017, No. 141, § 42*, eff. for tax years beginning on and after 1/1/2018. Acts 2003, No. 1273, § 11; 2011, No. 291, § 14.

S.D.C.L. Section 10-64-2

**10-64-2. Certain sellers located outside of state required to collect and remit sales taxes--
Criteria.**

Notwithstanding any other provision of law, any seller selling tangible personal property, products transferred electronically, or services for delivery into South Dakota, who does not have a physical presence in the state, is subject to chapters [10-45](#) and [10-52](#), shall remit the sales tax and shall follow all applicable procedures and requirements of law as if the seller had a physical presence in the state, provided the seller meets either of the following criteria in the previous calendar year or the current calendar year:

- (1) The seller's gross revenue from the sale of tangible personal property, any product transferred electronically, or services delivered into South Dakota exceeds one hundred thousand dollars; or
- (2) The seller sold tangible personal property, any product transferred electronically, or services for delivery into South Dakota in two hundred or more separate transactions.

Source: SL 2016, ch 70, § 1, eff. May 1, 2016.

A resort's sale of flexible time-share interests in condominiums was subject to sales tax. Sub. (2) (a) 1., as applied to sales of flexible time-shares, does not violate the Art. VIII, s. 1, "uniformity clause," nor does it violate guarantees of equal protection. *Telemark Development, Inc. v. DOR*, 218 Wis. 2d 809, 581 N.W.2d 585 (Ct. App. 1998), 97–3133.

A communications tower constructed on leased land was properly deemed "personal property." The owner of the tower was liable for sales tax on proceeds from renting or leasing space on the tower, and a renter of space on the tower was liable for use tax on its rental of space on the tower. *All City Communication Company, Inc. v. DOR*, 2003 WI App 77, 263 Wis. 2d 394, 661 N.W.2d 845, 02–1201.

Whether Milwaukee Symphony Orchestra concerts were entertainment events, ticket sales to which are subject to sales tax under sub. (2) (a) 2., depends on the "primary purpose" of the event. The determination is a holistic one that looks to the motivation, mission, or purpose of the sponsoring organization, as well as any evidence of the motivation and reaction of those paying admission and ultimately the nature of the place or event itself. If the primary purpose of an event or place is 50 percent or more "amusement, athletic, entertainment or recreational," then admission to the event or place is taxable under this provision of the statute. *Milwaukee Symphony Orchestra v. DOR*, 2010 WI 33, 324 Wis. 2d 68, 781 N.W.2d 674, 08–1684.

Sub. (2) (a) 1. does not impose a sales tax on those selling the service of making reservations on behalf of members of the public with those who furnish rooms or lodging. The omission of the words "the sale of" in sub. (2) (a) 1. indicates that the legislature did not intend to impose a tax on those selling the services of making hotel reservations but not actually furnishing the accommodations. *DOR v. Orbitz, L.L.C.*, 2016 WI App 22, 367 Wis. 2d 593, 877 N.W.2d 372, 15–0200.

The term "processing" in sub. (2) (a) 11. encompasses the performance of a mechanical or chemical operation on tangible personal property, a task that can be completed without transforming the property into a new product or adding anything to it that was not already there. Processing includes the separation of river sediment into its component parts. *Tetra Tech EC, Inc. v. DOR*, 2018 WI 75, 382 Wis. 2d 496, 914 N.W.2d 21, 15–2019.

The term "laundry services" in sub. (2) (a) 6. means work done for another to wash soiled clothes and linens. The undisputed facts of this case plainly show that, in exchange for a fee, the petitioner washed its clients' soiled clothes and linens. The primary purpose of the petitioner's contracts with its clients was not to have the petitioner merely provide a laundry department manager or the attendant managerial and administrative functions; it was for the client to obtain laundry services. The petitioner could not evade tax on laundry services simply by calling its services departmental or managerial, when the essence of those services was to clean its clients' laundry. *Healthcare Services Group, Inc. v. DOR*, 2018 WI App 48, 383 Wis. 2d 699, 916 N.W.2d 635, 17–0567.

A state may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the commerce clause. A court will sustain a tax so long as it: 1) applies to an activity with a substantial nexus with the taxing state; 2) is fairly apportioned; 3) does not discriminate against interstate commerce; and 4) is fairly related to the services the state provides. An out-of-state seller's liability to collect and remit sales taxes to the consumer's state does not depend on whether the seller has a physical presence in that state. Physical presence is not necessary to create a substantial nexus. *South Dakota v. Wayfair, Inc.*, 585 U.S. ___, 138 S. Ct. 2080, 201 L. Ed. 2d 403 (2018).

Changes on the Horizon: Sales and Use Tax in the E-Commerce Era. *Pascaly*. Wis. Law. Oct. 2015.

77.522 Sourcing. (1) GENERAL. (a) In this section:

1. "Receive" means taking possession of tangible personal property or items or property under s. 77.52 (1) (b) or (c); making first use of services; or taking possession or making first use of digital goods under s. 77.52 (1) (d), whichever comes first. "Receive" does not include a shipping company taking possession of tangible personal property or items or property under s. 77.52 (1) (b) or (c) on a purchaser's behalf.

2. "Transportation equipment" means any of the following:

a. Locomotives and railcars that are used to carry persons or property in interstate commerce.

b. Trucks and truck tractors that have a gross vehicle weight rating of 10,001 pounds or greater, trailers, semitrailers, and passenger buses, if such vehicles are registered under the international registration plan under s. 341.405 and operated under the authority of a carrier that is authorized by the federal government to carry persons or property in interstate commerce.

c. Aircraft that are operated by air carriers that are authorized by the federal government or a foreign authority to carry persons or property in interstate or foreign commerce.

d. Containers that are designed for use on the vehicles described in subd. 2. a. to c. and component parts attached to or secured on such vehicles.

(b) Except as provided in par. (c) and subs. (3), (4), and (5), the location of a sale is determined as follows:

1. If a purchaser receives the product at a seller's business location, the sale is sourced to that business location.

2. If a purchaser does not receive the product at a seller's business location, the sale is sourced to the location where the purchaser, or the purchaser's designated donee, receives the product,

including the location indicated by the instructions known to the seller for delivery to the purchaser or the purchaser's designated donee.

3. If the location of a sale of a product cannot be determined under subs. 1. and 2., the sale is sourced to the purchaser's address as indicated by the seller's business records, if the records are maintained in the ordinary course of the seller's business and if using that address to establish the location of a sale is not in bad faith.

4. If the location of a sale of a product cannot be determined under subs. 1. to 3., the sale is sourced to the purchaser's address as obtained during the consummation of the sale, including the address indicated on the purchaser's payment instrument, if no other address is available and if using that address is not in bad faith.

5. If the location of a sale of a product cannot be determined under subs. 1. to 4., including the circumstance in which the seller has insufficient information to determine the locations under subs. 1. to 4., the location of the sale is determined as follows:

a. If the item sold is tangible personal property or an item or property under s. 77.52 (1) (b) or (c), the sale is sourced to the location from which the tangible personal property or item or property under s. 77.52 (1) (b) or (c) is shipped.

b. If the item sold is a digital good or computer software delivered electronically, the sale is sourced to the location from which the digital good or computer software was first available for transmission by the seller, not including any location that merely provided the digital transfer of the product sold.

c. If a service is sold, the sale is sourced to the location from which the service was provided.

(c) 1. Except as provided in subd. 3., the sale of advertising and promotional direct mail, including a sale characterized under the laws of this state as the sale of a service when that service is an integral part of the production and distribution of printed material that meets the definition of advertising and promotional direct mail, is sourced to the location from which the advertising and promotional direct mail is shipped, if the purchaser does not provide to the seller a direct pay permit, an exemption certificate claiming direct mail, or other information that indicates the appropriate taxing jurisdiction to which the advertising and promotional direct mail is delivered to the ultimate recipients. If the purchaser provides an exemption certificate claiming direct mail or direct pay permit to the seller, the purchaser shall source the sales to the jurisdictions to which the advertising and promotional direct mail is delivered to the recipients and pay or remit, as appropriate, to the department the tax imposed under s. 77.53 on all purchases for which the tax is due and the seller, in the absence of bad faith, is relieved of all obligation to collect, pay, or remit the tax on any transaction to which the direct pay permit or exemption certificate applies. If the purchaser provides delivery information indicating the jurisdictions to which the advertising and promotional direct mail is to be delivered to the recipients, the seller shall source the sale to those jurisdictions and collect and remit the tax according to the delivery information provided by the purchaser and, in the absence of bad faith, the seller shall be relieved of any further obligation to collect tax on the sale of advertising and promotional direct mail for which the seller has sourced the sale and collected tax pursuant to the delivery information provided by the purchaser. If a transaction is a bundled transaction that includes advertising and promotional direct mail, this subdivision only applies if the primary purpose of the transaction is the sales of products or services that meet the definition of advertising and promotional direct mail.

2. The sale of other direct mail, including a sale characterized under the laws of this state as the sale of a service when that service is an integral part of the production and distribution of printed material that meets the definition of other direct mail, is sourced under par. (b) 3. if the purchaser does not provide to the seller a

direct pay permit or an exemption certificate claiming direct mail. If the purchaser provides an exemption certificate claiming direct mail or direct pay permit to the seller, the purchaser shall source the sale to the jurisdictions to which the other direct mail is to be delivered to the recipients and the purchaser shall pay or remit, as appropriate, to the department the tax imposed under s. 77.53 on all purchases for which the tax is due and the seller, in the absence of bad faith, is relieved of all obligation to collect, pay, or remit tax on any transaction to which the direct pay permit or exemption certificate claiming direct mail applies.

3. If advertising and promotional direct mail and other direct mail are included in a single mailing, the sale of that mailing is sourced the same as a sale of other direct mail.

4. Transactions that include the development of billing information or the provision of a data processing service that is more than incidental to producing direct mail are not direct mail and are sourced under par. (b), but transactions that include incidental data processing services are direct mail and are sourced under this paragraph. For purposes of this subdivision, “incidental” has the meaning given in s. 77.51 (5).

(3) LEASE OR RENTAL. (a) Except as provided in pars. (b) and (c), with regard to the first or only payment on the lease or rental, the lease or rental of tangible personal property or items, property, or goods under s. 77.52 (1) (b), (c), or (d) is sourced to the location determined under sub. (1) (b). Subsequent periodic payments on the lease or rental are sourced to the property’s, item’s, or good’s primary location as indicated by an address for the property, item, or good that is provided by the lessee and that is available to the lessor in records that the lessor maintains in the ordinary course of the lessor’s business, if the use of such an address does not constitute bad faith. The location of a lease or rental as determined under this paragraph shall not be altered by any intermittent use of the property, item, or good at different locations.

(b) The lease or rental of motor vehicles, trailers, semitrailers, and aircraft, that are not transportation equipment, is sourced to the primary location of such motor vehicles, trailers, semitrailers, or aircraft as indicated by an address for the property that is provided by the lessee and that is available to the lessor in records that the lessor maintains in the ordinary course of the lessor’s business, if the use of such an address does not constitute bad faith, except that a lease or rental under this paragraph that requires only one payment is sourced to the location determined under sub. (1) (b). The location of a lease or rental as determined under this paragraph shall not be altered by any intermittent use of the property at different locations.

(c) The lease or rental of transportation equipment is sourced to the location determined under sub. (1) (b).

(d) A license of tangible personal property or items, property, or goods under s. 77.52 (1) (b), (c), or (d) shall be treated as a lease or rental of such tangible personal property, items, property, or goods under this subsection.

(4) TELECOMMUNICATIONS. (a) In this subsection:

1. “Air-to-ground radiotelephone service” means a radio service in which common carriers are authorized to offer and provide radio telecommunications service for hire to subscribers in aircraft.

2. “Call-by-call basis” means any method of charging for telecommunications services by which the price of such services is measured by individual calls.

3. “Communications channel” means a physical or virtual path of communications over which signals are transmitted between or among customer channel termination points.

4. “Customer” means a person who enters into a contract with a seller of telecommunications services or, in any transaction for which the end user is not the person who entered into a contract with the seller of telecommunications services, the end user of the telecommunications services. “Customer” does not include a person who resells telecommunications services or, for mobile telecommunications services, a serving carrier under an agreement to

serve a customer outside the home service provider’s licensed service area.

5. “Customer channel termination point” means the location where a customer inputs or receives communications.

6. “End user” means the person who uses a telecommunications service. In the case of an entity, “end user” means the individual who uses the telecommunications service on the entity’s behalf.

7. “Home service provider” means a home service provider under section 124 (5) of P.L. 106–252.

8. “Mobile telecommunications service” means a mobile telecommunications service under 4 USC 116 to 126, as amended by P.L. 106–252.

9. “Place of primary use” means the residential street address or the primary business street address of the customer. In the case of mobile telecommunications services, “place of primary use” means a street address within the licensed service area of the home service provider.

10. “Postpaid calling service” means a telecommunications service that is obtained by paying for it on a call-by-call basis using a bankcard, travel card, credit card, debit card, or similar method, or by charging it to a telephone number that is not associated with the location where the telecommunications service originates or terminates. “Postpaid calling service” includes a telecommunications service, not including a prepaid wireless calling service, that would otherwise be a prepaid calling service except that the service provided to the customer is not exclusively a telecommunications service.

14. “Radio service” means a communication service provided by the use of radio, including radiotelephone, radiotelegraph, paging, and facsimile service.

15. “Radiotelegraph service” means transmitting messages from one place to another by means of radio.

16. “Radiotelephone service” means transmitting sound from one place to another by means of radio.

(b) Except as provided in pars. (d) to (j), the sale of a telecommunications service that is sold on a call-by-call basis is sourced to the taxing jurisdiction for sales and use tax purposes where the call originates and terminates, in the case of a call that originates and terminates in the same such jurisdiction, or the taxing jurisdiction for sales and use tax purposes where the call originates or terminates and where the service address is located.

(c) Except as provided in pars. (d) to (j), the sale of a telecommunications service that is sold on a basis other than a call-by-call basis is sourced to the customer’s place of primary use.

(d) The sale of a mobile telecommunications service, except an air-to-ground radiotelephone service and a prepaid calling service, is sourced to the customer’s place of primary use.

(e) The sale of a postpaid calling service is sourced to the location where the signal of the telecommunications service originates, as first identified by the seller’s telecommunications system or, if the signal is not transmitted by the seller’s telecommunications system, by information that the seller received from the seller’s service provider.

(f) The sale of a prepaid calling service or a prepaid wireless calling service is sourced to the location determined under sub. (1) (b), except that, if the service is a prepaid wireless calling service and the location cannot be determined under sub. (1) (b) 1. to 4., the prepaid wireless calling service occurs at the location determined under sub. (1) (b) 5. c. or at the location associated with the mobile telephone number, as determined by the seller.

(g) 1. The sale of a private communication service for a separate charge related to a customer channel termination point is sourced to the location of the customer channel termination point.

2. The sale of a private communication service in which all customer channel termination points are located entirely in one taxing jurisdiction for sales and use tax purposes is sourced to the

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taxing jurisdiction in which the customer channel termination points are located.

3. If the segments are charged separately, the sale of a private communication service that represents segments of a communications channel between 2 customer channel termination points that are located in different taxing jurisdictions for sales and use tax purposes is sourced to an equal percentage in both such jurisdictions.

4. If the segments are not charged separately, the sale of a private communication service for segments of a communications channel that is located in more than one taxing jurisdiction for sales and use tax purposes is sourced to each such jurisdiction in a percentage determined by dividing the number of customer channel termination points in that jurisdiction by the number of customer channel termination points in all jurisdictions where segments of the communications channel are located.

(i) The sale of an ancillary service is sourced to the customer's place of primary use.

(j) If the location of the customer's service address, channel termination point, or place of primary use is not known, the location where the seller receives or hands off the signal shall be considered, for purposes of this section, the customer's service address, channel termination point, or place of primary use.

(5) **FLORISTS.** (a) For purposes of this subsection, "retail florist" means a person engaged in the business of selling cut flowers, floral arrangements, and potted plants and who prepares such flowers, floral arrangements, and potted plants. "Retail florist" does not include a person who sells cut flowers, floral arrangements, and potted plants primarily by mail or via the Internet.

(b) Sales by a retail florist are sourced to the location determined by rule by the department.

History: 2009 a. 2, 28, 276, 330; 2013 a. 20; 2017 a. 59.

77.523 Liability of marketplace providers, retailers, and marketplace sellers. (1) A marketplace provider shall collect and remit tax on a sale facilitated on behalf of a marketplace seller, unless the marketplace provider has been granted a waiver under s. 77.52 (3m) (b).

(2) A marketplace provider who collects and remits tax on a sale under sub. (1) shall notify the marketplace seller that the marketplace provider is collecting and remitting the tax. Only the marketplace provider may be audited and held liable for the tax on the sale. Except for transactions for which a marketplace provider seeks relief under sub. (4), a marketplace seller shall not be subject to audit or held liable on marketplace provider transactions.

(4) A marketplace provider is relieved of liability under this section for failure to collect and remit the correct amount of tax to the extent that the marketplace provider demonstrates to the satisfaction of the department that the error is due to insufficient or incorrect information given to the marketplace provider by the marketplace seller, except that this subsection does not apply if the marketplace provider and the marketplace seller are related entities, as defined in s. 71.01 (9am). A marketplace seller that provides insufficient or incorrect information to the marketplace provider may be audited and held liable for the tax if the marketplace provider is relieved of liability under this subsection.

(6) Nothing in this section affects the obligations of a purchaser to remit use tax on a transaction for which the retailer or marketplace provider and marketplace seller did not collect and remit the tax.

History: 2019 a. 10.

77.524 Seller and 3rd-party liability. (1) In this section:

(ag) "Agent" means a person appointed by a seller to represent the seller before the states that are signatories to the agreement, as defined in s. 77.65 (2) (a).

(am) "Certified automated system" means software that is certified jointly by the states that are signatories to the agreement, as defined in s. 77.65 (2) (a), and that is used to calculate the sales tax and use tax imposed under this subchapter and subch. V on a trans-

action by each appropriate jurisdiction, to determine the amount of tax to remit to the appropriate state, and to maintain a record of the transaction.

(c) "Seller" has the meaning given in s. 77.65 (2) (e).

(1g) "Certified service provider" means an agent that is certified jointly by the states that are signatories to the agreement, as defined in s. 77.65 (2) (a), and that performs all of a seller's sales tax and use tax functions related to the seller's retail sales, except that a certified service provider is not responsible for a retailer's obligation to remit tax on the retailer's own purchases.

(2) A certified service provider is the agent of the seller with whom the certified service provider has contracted and is liable for the sales and use taxes that are due the state on all sales transactions that the provider processes for a seller, except as provided in sub. (3).

(3) A seller that contracts with a certified service provider is not liable for sales and use taxes that are due the state on transactions that the provider processed, unless the seller has misrepresented the type of items that the seller sells or has committed fraud. The seller is subject to an audit on transactions that the certified service provider processed only if there is probable cause to believe that the seller has committed fraud or made a material misrepresentation. The seller is subject to an audit on transactions that the certified service provider does not process. The states that are signatories to the agreement, as defined in s. 77.65 (2) (a), may jointly check the seller's business system and review the seller's business procedures to determine if the certified service provider's system is functioning properly and to determine the extent to which the seller's transactions are being processed by the certified service provider.

(4) A person that provides a certified automated system is responsible for the system's proper functioning and is liable to this state for tax underpayments that are attributable to errors in the system's functioning. A seller that uses a certified automated system is responsible and liable to this state for reporting and remitting sales and use tax.

(5) A seller that has a proprietary system for determining the amount of tax that is due on transactions and that has signed an agreement with the states that are signatories to the agreement, as defined in s. 77.65 (2) (a), establishing a performance standard for the system is liable for the system's failure to meet the performance standard.

History: 2001 a. 16; 2003 a. 321; 2009 a. 2.

77.525 Reduction to prevent double taxation. Any person who is subject to the tax under s. 77.52 (2) (a) 5. on telecommunications services that terminate in this state and who has paid a similar tax on the same services to another state may reduce the amount of the tax remitted to this state by an amount equal to the similar tax properly paid to another state on those services or by the amount due this state on those services, whichever is less. That person shall refund proportionally to the persons to whom the tax under s. 77.52 (2) (a) 5. was passed on an amount equal to the amounts not remitted.

History: 1997 a. 27; 2001 a. 109; 2009 a. 2.

77.53 Imposition of use tax. (1) Except as provided in sub. (1m), an excise tax is levied and imposed on the use or consumption in this state of taxable services under s. 77.52 purchased from any retailer, at the rate of 5 percent of the purchase price of those services; on the storage, use or other consumption in this state of tangible personal property and items or property under s. 77.52 (1) (b) or (c) purchased from any retailer, at the rate of 5 percent of the purchase price of the property or items; on the storage, use, or other consumption of goods in this state under s. 77.52 (1) (d) purchased from any retailer, if the purchaser has the right to use the goods on a permanent or less than permanent basis and regardless of whether the purchaser is required to make continued payments for such right, at the rate of 5 percent of the purchase price of the goods; and on the storage, use or other consumption of tangible personal property or items, property, or goods under s. 77.52 (1)

STREAMLINED SALES AND USE TAX AGREEMENT

**Adopted November 12, 2002 and amended
through May 20, 2021**

(Amended November 19, 2003, November 16, 2004, April 16, 2005, October 1, 2005, January 13, 2006, April 18, 2006, August 30, 2006, December 14, 2006, June 23, 2007, September 20, 2007, December 12, 2007, April 2, 2008, June 18, 2008, September 5, 2008, December 6, 2008, February 26, 2009, May 12, 2009, September 30, 2009, December 17, 2009, March 31, 2010, April 30, 2010, August 17, 2010, October 7, 2010, November 8, 2010, December 13, 2010, May 19, 2011, December 19, 2011, May 24, 2012, October 7, 2012, October 30, 2013, May 15, 2014, October 8, 2014, May 13, 2015, September 17, 2015, May 4, 2016, October 14, 2016, December 16, 2016, May 11, 2017, October 11, 2017, December 19, 2017, May 3, 2018, December 14, 2018, December 20, 2019, December 18, 2020, March 5, 2021, and May 20, 2021)

ARTICLE I

PURPOSE AND PRINCIPLE

Section 101: TITLE

This multistate Agreement shall be referred to, cited, and known as the Streamlined Sales and Use Tax Agreement.

Section 102: FUNDAMENTAL PURPOSE

It is the purpose of this Agreement to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance. The Agreement focuses on improving sales and use tax administration systems for all sellers and for all types of commerce through all of the following:

- A. State level administration of sales and use tax collections.
- B. Uniformity in the state and local tax bases.
- C. Uniformity of major tax base definitions.
- D. Central, electronic registration system.
- E. Simplification of state and local tax rates.
- F. Uniform sourcing rules for all taxable transactions.
- G. Simplified administration of exemptions.
- H. Simplified tax returns.
- I. Simplification of tax remittances.
- J. Protection of consumer privacy.

See Compiler's Notes for History.

Section 103: TAXING AUTHORITY PRESERVED

This Agreement shall not be construed as intending to influence a member state to impose a tax on or provide an exemption from tax for any item or service. However, if a member state chooses to tax an item or exempt an item from tax, that state shall adhere to the provisions concerning definitions as set out in Article III of this Agreement.

Section 309: APPLICATION OF GENERAL SOURCING RULES AND EXCLUSIONS FROM THE RULES

- A. Each member state shall agree to require sellers to source the retail sale of a product in accordance with Section 310 or Section 310.1. Except as provided in Section 310.1, the provisions of Section 310 apply to all sales regardless of the characterization of a product as tangible personal property, a digital good, or a service. Except as otherwise provided in this Agreement, the provisions of Section 310 and Section 310.1 only apply to determine a seller's obligation to pay or collect and remit a sales or use tax with respect to the seller's retail sale of a product. These provisions do not affect the obligation of a purchaser or lessee to remit tax on the use of the product to the taxing jurisdictions of that use.
- B. Sections 310 and 310.1 do not apply to sales or use taxes levied on the following:
1. The retail sale or transfer of watercraft, modular homes, manufactured homes, or mobile homes. These items must be sourced according to the requirements of each member state.
 2. The retail sale, excluding lease or rental, of motor vehicles, trailers, semi-trailers, or aircraft that do not qualify as transportation equipment, as defined in Section 310, subsection (D). The retail sale of these items shall be sourced according to the requirements of each member state, and the lease or rental of these items must be sourced according to Section 310, subsection (C).
 3. Telecommunications services and ancillary services, as set out in Section 315, and Internet access service shall be sourced in accordance with Section 314.
 4. Florist sales as defined by each member state. Such sales must be sourced according to the requirements of each member state.
 5. The retail sale of products and services qualifying as direct mail shall be sourced in accordance with Section 313.

See Compiler's Notes for history.

Section 310: GENERAL SOURCING RULES

- A. Except as provided in Section 310.1, the retail sale, excluding lease or rental, of a product shall be sourced as follows:

1. When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.
 2. When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.
 3. When subsections (A)(1) and (A)(2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.
 4. When subsections (A)(1), (A)(2), and (A)(3) do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser's payment instrument, if no other address is available, when use of this address does not constitute bad faith.
 5. When none of the previous rules of subsections (A)(1), (A)(2), (A)(3), or (A)(4) apply, including the circumstance in which the seller is without sufficient information to apply the previous rules, then the location will be determined by the address from which tangible personal property was shipped, from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or from which the service was provided (disregarding for these purposes any location that merely provided the digital transfer of the product sold).
- B. The lease or rental of tangible personal property, other than property identified in subsection (C) or subsection (D), shall be sourced as follows:
1. For a lease or rental that requires recurring periodic payments, the first periodic payment is sourced the same as a retail sale in accordance with the provisions of subsection (A). Periodic payments made subsequent to the first payment are sourced to the primary property location for each period covered by the payment.

The primary property location shall be as indicated by an address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business, when use of this address does not constitute bad faith. The property location shall not be altered by intermittent use at different locations, such as use of business property that accompanies employees on business trips and service calls.

2. For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the provisions of subsection (A).

3. This subsection does not affect the imposition or computation of sales or use tax on leases or rentals based on a lump sum or accelerated basis, or on the acquisition of property for lease.

C. The lease or rental of motor vehicles, trailers, semi-trailers, or aircraft that do not qualify as transportation equipment, as defined in subsection (D), shall be sourced as follows:

1. For a lease or rental that requires recurring periodic payments, each periodic payment is sourced to the primary property location. The primary property location shall be as indicated by an address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business, when use of this address does not constitute bad faith. This location shall not be altered by intermittent use at different locations.

2. For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the provisions of subsection (A).

3. This subsection does not affect the imposition or computation of sales or use tax on leases or rentals based on a lump sum or accelerated basis, or on the acquisition of property for lease.

D. The retail sale, including lease or rental, of transportation equipment shall be sourced the same as a retail sale in accordance with the provisions of subsection (A),

notwithstanding the exclusion of lease or rental in subsection (A). “Transportation equipment” means any of the following:

1. Locomotives and railcars that are utilized for the carriage of persons or property in interstate commerce.
2. Trucks and truck-tractors with a Gross Vehicle Weight Rating (GVWR) of 10,001 pounds or greater, trailers, semi-trailers, or passenger buses that are:
 - a. Registered through the International Registration Plan; and
 - b. Operated under authority of a carrier authorized and certificated by the U.S. Department of Transportation or another federal authority to engage in the carriage of persons or property in interstate commerce.
3. Aircraft that are operated by air carriers authorized and certificated by the U.S. Department of Transportation or another federal or a foreign authority to engage in the carriage of persons or property in interstate or foreign commerce.
4. Containers designed for use on and component parts attached or secured on the items set forth in subsections (D)(1) through (D)(3).

See Compiler's Notes for history.

Interpretations issued: (a) The Governing Board issued Interpretation 2006-03 on April 18, 2006 relating to the sourcing of initial lease payments made to dealers. That interpretation can be found in the Library of Interpretations in Appendix D.

(b) The Governing Board issued Interpretation 2007-02 on September 20, 2007 relating to the sourcing of sales when a third party shipping company picks up the product at the seller's location. That interpretation can be found in the Library of Interpretations in Appendix D.

Section 310.1: ELECTION FOR ORIGIN-BASED SOURCING

- A. A member state that has local jurisdictions that levy or receive sales or use taxes may elect to source the retail sale of tangible personal property and digital goods pursuant to the provisions of this section in lieu of the provisions of subsection A (2), (3) and (4) of Section 310 if they comply with all provisions of subsection (C) of this section and the only exception to Section 310 is the exception provided for in subsection (B) of this section.
- B. A member state may source retail sales, excluding lease or rental, of tangible personal property or digital goods to the location where the order is received by the seller if:

(120) days. The member state may not limit direct pay applicants to businesses engaged in manufacturing or businesses that do not know the ultimate use of the product at the time of the purchase.

7. When taxable services are sold with tangible personal property or digital products pursuant to a single contract or in the same transaction, are billed on the same billing statement(s), and, because of the application of this section, would be sourced to different jurisdictions, a member state shall elect either origin sourcing or destination sourcing to determine a single situs for that transaction. Such member state election is required until such time as the Governing Board adopts a uniform methodology to address such sales.
8. A member state that elects to source the sale of tangible personal property and digital goods pursuant to the provisions of this section shall inform the Governing Board of such election.

See Compiler's Notes for history.

Section 311: GENERAL SOURCING DEFINITIONS

For the purposes of Section 310, subsection (A), the terms "receive" and "receipt" mean:

- A. Taking possession of tangible personal property,
- B. Making first use of services, or
- C. Taking possession or making first use of digital goods, whichever comes first.

The terms "receive" and "receipt" do not include possession by a shipping company on behalf of the purchaser.

Section 312: MULTIPLE POINTS OF USE (Repealed on December 14, 2006)

See Compiler's Notes for history.

Section 313: DIRECT MAIL SOURCING

A. Notwithstanding Sections 310 and 310.1, the following provisions apply to sales of "advertising and promotional direct mail:"

1. A purchaser of "advertising and promotional direct mail" may provide the seller with either:

- a. A direct pay permit.
- b. An Agreement certificate of exemption claiming “direct mail” (or other written statement approved, authorized or accepted by the state); or
- c. Information showing the jurisdictions to which the “advertising and promotional direct mail” is to be delivered to recipients.

2. If the purchaser provides the permit, certificate or statement referred to in subparagraph a or b of paragraph 1 of subsection (A) of this section, the seller, in the absence of bad faith, is relieved of all obligations to collect, pay, or remit any tax on any transaction involving “advertising and promotional direct mail” to which the permit, certificate or statement applies. The purchaser shall source the sale to the jurisdictions to which the “advertising and promotional direct mail” is to be delivered to the recipients and shall report and pay any applicable tax due.

3. If the purchaser provides the seller information showing the jurisdictions to which the “advertising and promotional direct mail” is to be delivered to recipients, the seller shall source the sale to the jurisdictions to which the “advertising and promotional direct mail” is to be delivered and shall collect and remit the applicable tax. In the absence of bad faith, the seller is relieved of any further obligation to collect any additional tax on the sale of “advertising and promotional direct mail” where the seller has sourced the sale according to the delivery information provided by the purchaser.

4. If the purchaser does not provide the seller with any of the items listed in subparagraphs a, b or c of paragraph 1 of subsection (A) of this section, the sale shall be sourced according to Section 310.A.5. The state to which the “advertising and promotional direct mail” is delivered may disallow credit for tax paid on sales sourced under this paragraph.

B. Notwithstanding Sections 310 and 310.1, the following provisions apply to sales of “other direct mail.”

1. Except as otherwise provided in this paragraph, sales of “other direct mail” are sourced in accordance with Section 310.A.3.

2. A purchaser of “other direct mail” may provide the seller with either:

- a. A direct pay permit; or

b. An Agreement certificate of exemption claiming “direct mail” (or other written statement approved, authorized or accepted by the state).

3. If the purchaser provides the permit, certificate or statement referred to in subparagraph a or b of paragraph 2 of subsection (B) of this section, the seller, in the absence of bad faith, is relieved of all obligations to collect, pay or remit any tax on any transaction involving “other direct mail” to which the permit, certificate or statement apply.

Notwithstanding paragraph 1 subsection (B), the sale shall be sourced to the jurisdictions to which the “other direct mail” is to be delivered to the recipients and the purchaser shall report and pay applicable tax due.

C. For purposes of this section:

1. “Advertising and promotional direct mail” means:

a. printed material that meets the definition of “direct mail,” in Appendix C, Part 1;

b. the primary purpose of which is to attract public attention to a product, person, business or organization, or to attempt to sell, popularize or secure financial support for a product, person, business or organization. As used in this subsection, the word “product” means tangible personal property, a product transferred electronically or a service.

2. “Other direct mail” means any direct mail that is not “advertising and promotional direct mail” regardless of whether “advertising and promotional direct mail” is included in the same mailing. The term includes, but is not limited to:

a. Transactional direct mail that contains personal information specific to the addressee including, but not limited to, invoices, bills, statements of account, payroll advices;

b. Any legally required mailings including, but not limited to, privacy notices, tax reports and stockholder reports; and

c. Other non-promotional direct mail delivered to existing or former shareholders, customers, employees, or agents including, but not limited to, newsletters and informational pieces.

Other direct mail does not include the development of billing information or the provision of any data processing service that is more than incidental.

D. 1. a. This section applies to a transaction characterized under state law as the sale of services only if the service is an integral part of the production and distribution of printed material that meets the definition of “direct mail.”

b. This section does not apply to any transaction that includes the development of billing information or the provision of any data processing service that is more than incidental regardless of whether “advertising and promotional direct mail” is included in the same mailing.

2. If a transaction is a “bundled transaction” that includes “advertising and promotion direct mail,” this section applies only if the primary purpose of the transaction is the sale of products or services that meet the definition of “advertising and promotional direct mail.”

3. Nothing in this section shall limit any purchaser’s:

a. Obligation for sales or use tax to any state to which the direct mail is delivered,

b. Right under local, state, federal or constitutional law, to a credit for sales or use taxes legally due and paid to other jurisdictions, or

c. Right to a refund of sales or use taxes overpaid to any jurisdiction.

4. This section applies for purposes of uniformly sourcing “direct mail” transactions and does not impose requirements on states regarding the taxation of products that meet the definition of “direct mail” or to the application of sales for resale or other exemptions.

See Compiler’s Notes for history.

Section 313.1: ELECTION FOR ORIGIN-BASED DIRECT MAIL SOURCING

A. Notwithstanding Sections 310, 310.1 and 313, a member state may elect to source the sale of all direct mail delivered or distributed from a location within the state and delivered or distributed to a location within the state pursuant to the provisions of this section.

B. If the purchaser provides the seller with a direct pay permit or an Agreement certificate of exemption claiming direct mail (or other written statement approved, authorized or accepted by the state), the seller, in the absence of bad faith, is relieved

This Project recommendation was approved in an October 31, 2002 teleconference.

STREAMLINED SALES TAX PROJECT

SOURCING DIRECT MAIL

(October 31, 2002)

Issues

1. Should the sourcing rules adopted by SSTP be modified to simplify sourcing of direct mail transactions?
2. If yes, how should "direct mail" be defined?

Background

For purposes of the following discussion only, "direct mail" refers to items delivered or distributed to a mass audience or to a mailing list provided at the direction of the customer when the cost of the items are not billed directly to the recipients. "Direct mail" does not include bulk shipments of items to a single address.

Under the SSTP sourcing rules, items are sourced in the following order depending on the information available to the seller:

1. To the seller's location for over-the-counter sales.
2. To the location known to the seller where the purchaser or the purchaser's donee receives the item. Possession by a carrier on behalf of the purchaser does not constitute receipt.
3. To the business address of the purchaser (e.g., billing address), unless use of this address is in bad faith.
4. To any other address the seller has for the purchaser, unless use of this address is in bad faith.
5. When none of the above apply:
 - If tangible personal property, the address from which the item is shipped,
 - If a digital good, the address from which the digital good was first available for transmission by the seller, or
 - If a service, the address from which the service was provided.

Direct mail cannot, by definition, be sourced under Rule 1.

There is uncertainty about whether Rule 2 applies to sellers of direct mail. Printers note that although the customer provides a mailing list of addresses to the seller (printer), the printer does not retain sufficient information that would allow sourcing to the destination location, especially with the enormous number of local jurisdictions. Some may interpret the fact that the printer has the mailing list, for the sole purpose of printing addresses on the printed material, constitutes knowing the ultimate destination of the mailings.

The printers have stated that, generally, the mailing list is proprietary information of their customer. Due to the sensitive nature of this data and because large printers print for multiple customers who may be competitors, they are not allowed to keep the mailing lists or documentation of the list once the printing job is completed. In most instances, they do not keep any record of where the items printed are ultimately mailed.

Some may argue that if a printer must properly sort the items for mailing under postal regulations, it must know the destination of each item of direct mail. The customer, in order to achieve the greatest savings in postage, often will sort the mailing list and that determines the sort done by the printer in readying the printed material for mailing. In some cases, the printer presorts the mailing for the customer, using a canned software package that sorts the mail into categories, to get the best postage rate. This may be down to the level of a mail carrier route, but recent changes in the postal rates make this sort less attractive. Printers have indicated that the software used for sorting is for postal delivery routes and is not tax effective for determining tax jurisdictions.

Since the printer does not retain the mailing list they do not have information available at the time of audit to verify where products or services relating to direct mail were sold. If everyone can agree that the printer does not know, or cannot reasonably be expected to know, where the items are shipped, Rule 2 does not apply.

Note: In early discussions of the general sourcing rules, drafters of the sourcing rules were concerned that since a printer has general knowledge that direct mail goes to multiple taxing jurisdictions, dropping to Rule 3 or Rule 4 constitutes "bad faith." That would require use of Rule 2 by sellers of direct mail, which may be impossible for the seller to properly administer. However, authors of this paper believe that general knowledge of multi-jurisdiction deliveries does not constitute "bad faith" for purposes of Rule 3 or 4.

If Rules 1 and 2 do not apply, the next default would be Rule 3. The seller would source the transaction to the customer's address. Printers agree that they will always have an address for their customer (billing or some other address). Generally, this is going to be the "Bill To" address of the customer. However, the states have a concern of defaulting to this rule. This is an address that the seller can control to obtain favorable tax treatment. However, the state of the billing address may in no way be affected by the transaction (i.e., the seller is not located there and the direct mail may never be delivered in that state).

If Rule 3 were not acceptable, Rule 4 would also not be acceptable, as this is some other address of the customer that the seller may have, such as an address for the payment instrument. The remaining default left to consider is Rule 5, which is the location from where the property was shipped.

Example: Printer A (located in New Jersey) is hired by Customer B (located in South Dakota) to print 500,000 catalogs. Customer B provides a mailing list in label form to Printer A. Customer B, to achieve the greatest savings in postage, has sorted the mailing list. Printer A prints the catalogs, packages them pursuant to U.S. Postal Service regulations, and affixes a mailing label to each catalog. The catalogs, as sorted by the customer, are put on pallets and delivered to the nearest U.S. Postal Service facility. Very often, the Postal Service facility is located at the printer's facility. If not at the printer's facility, either the U.S. Postal Service or a common carrier will transport the printed materials from the printer's facility to a Bulk Mail Facility or other postal facility. The U.S. Postal Service delivers the catalogs to addresses in 10 eastern states that have a sales tax.

Using Rule 2 to source direct mail requires the printer to know the exact destination for each of the 500,000 catalogs that are shipped in order to properly collect sales or use tax. In the event of an audit of the printer, information would not be available to taxing jurisdictions to verify the exact destination since the seller does not retain the mailing lists or documents detailing the destination addresses. There will be subjective questions by taxing jurisdictions about how much information a printer has with respect to the destinations of particular mailing and whether the seller may default to Rule 3 for purposes of sourcing the transaction. Using Rule 3 in the above example would require the seller to source the transaction to South Dakota, even though none of the catalogs go to that state. Using Rule 5, the printer would collect New Jersey tax on the transaction.

Purchasers have control and/or ownership of the information needed to correctly source direct mail to the specific taxing jurisdictions where they are delivered. Printers believe there are purchasers of direct mail, who would clearly prefer to handle the responsibility of correctly reporting tax to the jurisdiction where the direct mail is delivered and used. Several large retailers present at the Sourcing Workgroup meeting in Salt Lake City (07/02), where the direct mail issue was discussed, confirmed their willingness to handle this responsibility.

Alternatives to Consider

Issue One – Should Sourcing Rules Be Modified for Direct Mail?

1. Do not modify existing sourcing rules for direct mail sales.
2. Allow purchasers to use a Direct Mail Form relieving the seller of collecting tax on the transaction. If the purchaser does not use the Direct Mail Form for purchases of direct mail, the seller must source the transaction under Rule 3 (e.g., billing address).
3. Require that purchasers provide to the seller one of the following:
 - A Direct Mail Form, which would relieve the seller of collecting any sales or use tax on the transaction.
 - Information as to the jurisdictions where the direct mail is delivered so that the seller may properly source the transaction.

If the purchaser fails to provide to the printer the Direct Mail Form or information on delivery jurisdictions, the seller will collect tax based on the location from where the direct

mail was shipped (origin). The purchaser is still liable for tax in the state where the property is stored, used, or consumed based on existing state law. A state where the property is delivered will not be required to give credit to the purchaser for tax collected in the state of origin. For failing to provide the required information, the purchaser will have to go back to the state of origin for any tax collected by the seller.

4. Mandate use of a Direct Mail Form for purchases of direct mail thereby relieving the seller of collecting tax on any direct mail transactions.

Issue Two – Definition of Direct Mail

1. Define direct mail as any tangible personal property delivered or distributed by U.S. Mail or other for-hire carrier to a mass audience or to a mailing list provided by a purchaser or at the direction of a purchaser if:
 - a. The addressee is not directly billed for the tangible personal property, and
 - b. Not more than one item of the tangible personal property is delivered to a single addressee.

Examples: Catalogs, brochures, billing invoices, and coupon booklets, product samples, promotional gifts provided with printed material, and holiday gifts, such as candy and gift baskets, with or without printed material.

2. Define direct mail as printed material delivered or distributed by U.S. Mail or other for-hire carrier to a mass audience or to a mailing list provided by a purchaser or at the direction of a purchaser if:
 - a. The addressee is not directly billed for the printed material, and
 - b. Not more than one package of the printed material is delivered to a single addressee.

Examples: Catalogs, brochures, billing invoices, calendars, and coupon booklets. If other items, such as product samples, are included in the package, the package is not direct mail for sourcing purposes.

3. Define direct mail as printed material, that may be in combination with other tangible personal property, delivered or distributed by U.S. Mail or other for-hire carrier to a mass audience or to a mailing list provided by a purchaser or at the direction of a purchaser if:
 - a. The addressee is not directly billed for the tangible personal property, and
 - b. Not more than one package of the tangible personal property is delivered to a single addressee.

Printed material will still be direct mail even though inserted with the printed material is other tangible personal property that has been purchased from a person other than the seller of the direct mail and supplied by the purchaser or another person at the direction of the purchaser to the seller of the direct mail.

Examples: Coupons or brochures with a sample of the product.

Recommendation

Issue One

Alternative 3 – Amend sourcing rules to require the use of the direct mail form by purchasers of direct mail or that they provide delivery information to the seller. If the purchaser does not provide the seller with the Direct Mail Form or delivery information, the seller of direct mail must collect tax under Rule 5.

Issue Two

Alternative 3 – Limit direct mail to printed material. However, allow printed material to include tangible personal property supplied by the customer to the direct mail seller for inclusion in the package containing the printed material. This is consistent with the definition of direct mail adopted by the Implementing States in addressing an exclusion from delivery charges related to direct mail.

Discussion of Alternatives (with reference to perspectives of the seller, purchaser, and states/SSTP)

Issue One, Alternative One - Do not modify existing sourcing rules for direct mail sales

1. Seller

- Lack of clarity in interpreting existing sourcing rules as they apply to direct mail. Does the printer use Rule 2 or Rule 3 where there is general knowledge, but no specific knowledge or documentation available for the destinations?
- It is impractical to require printers to circumvent business practices relating to proprietary mailing lists of customers in order for a seller to accurately apply a destination-sourcing rule.
- If the seller cannot ascertain the destination of direct mail, a Certified Service Provider, will not be in a position to determine the appropriate taxing jurisdiction either.

2. Purchaser

- It may be easier for some purchasers to have the seller collect and remit to the place of destination.
- If the transaction defaults to the “Bill To” address, the purchaser may have difficulty in obtaining credit for tax paid from tax jurisdictions where the direct mail is actually stored, used, or consumed.
- Purchasers using multiple print vendors may encounter different interpretations of the sourcing rules, complicating their attempts to apply tax consistently and correctly.

3. State/SSTP

- Providing special sourcing rules for a specific product or industry may encourage further modifications in the sourcing rules that creates complexity.
- If destination can be ascertained, it is generally more efficient for states to collect from one seller rather than multiple purchasers.

Issue One, Alternative Two - Allow purchasers to use Direct Mail Form for direct mail. If the purchaser does not use the Direct Mail Form for purchases of direct mail, the sale must be sourced by the seller under Rule 3.

1. Seller

- Purchasers giving a Direct Mail Form will relieve the seller of any burden to collect tax. However, if none is given, it is simple to source the transaction to the single billing address.
- Customer and audit issues may arise over the “bad faith” exception to Rules 3 and 4. Sellers may be required to reject a customer’s superficial attempt to shift their business address to a state without a sales or use tax. If sellers do not reject such attempts, they may have a liability upon audit.

2. Purchaser – The purchaser makes the call on whether it wants the seller to retain the burden of remitting the tax. This allows the purchaser to apply consistent tax treatment for all print purchases.

3. State/SSTP

- States will not have to make subjective determinations on whether a printer does or does not have sufficient information of destination addresses so that they know whether to apply Sourcing Rule 2 or 3 to direct mail. Without a Direct Mail Form, Rule 3 will always apply.
- The billing address is easy for a state to determine.
- Disputes could arise over superficial attempts to switch business addresses to a state without a sales or use tax. The states will have to determine whether the seller’s acceptance of such attempts constitutes bad faith.
- A state may collect revenue even though the property never comes into the state.
- If a Direct Mail Form is used, a taxing jurisdiction may not always have the authority to impose a sales or use tax on the purchaser of direct mail that is ultimately delivered into the jurisdiction. Reasons for this lack of authority are:
 - The purchaser does not have nexus in the taxing jurisdiction.

- Even if a purchaser does have nexus in a taxing jurisdiction, the taxing jurisdiction does not have a statutory definition of use that allows it to impose tax on property delivered into the taxing jurisdiction where the purchaser has not had physical possession of the property (See Appendix A).
- For transactions that must be sourced to the billing address because a Direct Mail Form is not given by the customer, several states will see little change from existing law because they have an exemption for certain printed and promotional material that is shipped outside the state for use outside the state (e.g., California, Connecticut, Kentucky, Maine, Massachusetts, Minnesota, New Jersey, New York, Ohio, Pennsylvania, South Carolina, Tennessee, Virginia, and Wisconsin).

Issue One, Alternative Three - Require purchasers to provide Direct Mail Form or delivery information to seller. If the purchaser does not provide the Direct Mail Form or delivery information, the tax is collected by the seller using Rule 5.

1. Seller

- Purchasers giving a Direct Mail Form will relieve the seller of any burden to collect tax. Purchasers giving delivery information eliminate uncertainty by a seller of where delivery takes place. However, if none of the required information is provided by the purchaser, it is simple to source the transaction to the location from where the direct mail was shipped (origin).
- Customer and audit issues may arise over the “bad faith” exception to Rules 3 and 4 if a clear default rule is not put in place. Sellers may be required to reject a customer’s superficial attempt to shift their business address to a state without a sales or use tax. If sellers do not reject such attempts, they may have a liability upon audit.

2. Purchaser

- The purchaser makes the call on whether it wants the seller to retain the burden of remitting the tax by giving the seller delivery information. This allows the purchaser to apply consistent tax treatment for all print purchases.
- There is some risk to purchaser for failing to provide the required information. Although the state of origin receives the tax, a tax may still be due in the state of delivery. If the state of delivery is not required to give credit for tax paid to the origin state, the purchaser must go to the state of origin for a refund or face overpayment of tax.

3. State/SSTP

- States will not have to make subjective determinations on whether a printer does or does not have sufficient information of destination addresses so that they know whether to apply Sourcing Rule 2 or 3 to direct mail. Without the required information, Rule 5 will always apply.
- The origin is easy for a state to determine.

- There is an incentive for the purchaser to provide the Direct Mail Form or delivery information.
- If a Direct Mail Form is used, a taxing jurisdiction may not always have the authority to impose a sales or use tax on the purchaser of direct mail that is ultimately delivered into the jurisdiction. Reasons for this lack of authority are:
 - The purchaser does not have nexus in the taxing jurisdiction.
 - Even if a purchaser does have nexus in a taxing jurisdiction, the taxing jurisdiction does not have a statutory definition of use that allows it to impose tax on property delivered into the taxing jurisdiction (See Appendix A).

Issue One, Alternative Four - Mandate use of Direct Mail Form for purchases of direct mail

1. Seller

- The seller is always relieved of collecting sales or use tax on sales of direct mail. However, without a default rule in the event of the purchaser not providing the required Direct Mail Form, it is not clear of what liability a seller will have. If it does have a liability to collect, it is not clear which rule should be used.
- Eliminates the potential liability for a “bad faith” use of default Rule 3 or 4.

2. Purchaser

- For some purchasers, this may be advantageous, as they prefer to be solely responsible for reporting tax liability directly to the taxing jurisdiction. They feel this gives them certainty that they are not paying more than their fair share.
- Some purchasers like the fact that the seller remits the tax on their behalf, relieving them of some administrative burden self-reporting would require.

3. State/SSPT

- Other sellers will wish to have their collection burdens removed as well.
- Eliminates potential disputes upon audit about a “bad faith” use of default Rule 3 or 4.
- A taxing jurisdiction may not always have the authority to impose a sales or use tax on the purchaser of direct mail that is ultimately delivered into the jurisdiction. Reasons for this lack of authority are:
 - The purchaser does not have nexus in the taxing jurisdiction.
 - Even if a purchaser does have nexus in a taxing jurisdiction, the taxing jurisdiction does not have a statutory definition of use that allows it to impose tax on property

delivered into the taxing jurisdiction if the purchaser did not have physical possession of the property (See Appendix A).

- Three states have enacted legislation that has the effect of Alternative 4, reducing or eliminating the printer's burden to collect tax on direct mail and shifting the burden directly to the purchasers. (See Appendix B)

Issue Two, Alternative One – Define Direct Mail Broadly to All Tangible Personal Property

1. Seller – Industries, in addition to printing, will benefit from simplification.
2. Purchaser – Purchasers of direct mail from industries other than printing may prefer to remit tax to the seller rather than have accounts payable staff remember to self-assess tax due.
3. State
 - Simplifies audits of other industries from a sales perspective, but audits of their customers may be more complex as a result.
 - Promotes equal treatment of like-transactions and consistency in the taxation of mass mailings.
 - Other industries may be more likely to support this proposal if their mass mailings are treated in the same manner.

Issue Two, Alternative Two – Limit Direct Mail to Printed Material

1. Seller
 - Not all printed material sent by direct mail will be treated the same. For example, if a product sample is sent along with the printed material, the item does not meet the definition of direct mail since it contains more than the printed material.
 - Other sellers may oppose this limitation since the same concerns raised by the printers (e.g., not retaining mailing lists to know destination) could be raised for items sold to customers for distribution by the seller to mass audiences.
2. Purchaser – Some common promotional items will be excluded from the special sourcing rules.
3. State
 - It may be confusing for a state to differentiate between qualifying and non-qualifying products upon audit.
 - Creates inconsistency in taxing like-transactions.

Issue Two, Alternative Three – Limit Direct Mail to Printed Materials That May Contain Certain Other Tangible Personal Property

1. Seller – Clearer guidelines to follow for all printed items sent by direct mail.
2. Purchaser - Clearer guidelines to follow for all printed items sent by direct mail.
3. State
 - Clearer guidelines to follow for all printed items sent by direct mail.
 - A few states strictly limit exclusions to collect or exemptions to printed material only.
 - The Implementing states have already adopted a definitions of direct mail identical to this alternative for purposes of excluding from sales price certain delivery charges.

State Jurisdiction to Impose Use Tax on a Purchaser

Example: *Company A purchases catalogs from Company B, a printer. Company A directs Company B to deliver the catalogs via the U.S. Mail to recipients throughout the United States. Company A has nexus in every state. Company B has nexus in its home state only and sales of catalogs in that state are exempt from sales or use tax. Is Company A subject to use tax on its purchases of catalogs delivered to recipients in jurisdictions that have a sales or use tax?*

At least 25 states rely on the *D.H. Holmes* decision and impose use tax on tangible personal property used or distributed in the state when the seller is not required to collect that state's tax or for some other reason does not collect the tax. However, states are limited to imposing the tax on purchaser's that have nexus (a physical presence within their state). See *Quill Corp. v. North Dakota*, 504 US 298, 119 L Ed 2d 91. Sales to a company outside of the state that only mails printed materials into the state would not be taxed. In addition, there are several states that do not have the statutory authority to impose use tax on the purchaser (e.g., Illinois, Wisconsin).

In the case of *D.H. Holmes Co., Ltd. v. Shirley McNamara, Secretary of Revenue and Taxation of Louisiana* (Docket No. 87-267, May 16, 1988, 486 U.S. 24, 108 S.Ct. 1619), the U.S. Supreme Court affirmed a Louisiana Court of Appeals decision holding that imposition of Louisiana use tax on the value of direct-mail catalogs printed outside the state and mailed by a Louisiana retail store chain free of charge to selected Louisiana residents did not violate the Commerce Clause of the U.S. Constitution. Under Louisiana law, distribution constituted a taxable "use." Therefore, the argument that the use tax was a tax on the mere presence of goods within the state was without merit, according to the U.S. Supreme Court. Furthermore, the application of the tax satisfied the four-pronged test of *Complete Auto Transit* (430 U.S. 274 (1977)), because the state's taxing scheme was fairly apportioned, it did not discriminate against interstate commerce, the use tax was fairly related to state-provided services that facilitated the taxpayer's in-state sales, and the taxpayer's activity had a sufficient nexus (connection) with the taxing state.

A state, however, could revise its law to follow *D.H. Holmes*, thereby allowing it to at least collect use tax from purchasers with nexus in their state on purchases of the printed material stored, used, or consumed in the state.

**States that Have Removed Printers' Burden to
Collect Sales of Use Tax on Sales of Direct Mail**

The states of Florida, Texas, and Tennessee have laws that excuse the printer from collecting tax on sales of printed material shipped to individuals. Florida and Texas both presume that tax is due and the printer must collect it unless the customer provides an exemption certificate. Tennessee law is less clear, but commercial printers are excused from collecting tax in some cases.

1. Florida

Statutes § 212.06 (3) (b)1. A purchaser of printed materials shall have sole responsibility for the taxes imposed by this chapter on those materials when the printer of the materials delivers them to the United States Postal Service for mailing to persons other than the purchaser located within and outside this state. However, if all, or substantially all, of the printed materials will be delivered to persons in Florida, the printer remains obligated to collect the tax. It is presumed that all materials printed at a Florida printing facility are to be delivered within Florida. The printer must obtain a certificate from the purchaser pertaining to the delivery of the printed material to allow an exemption.

2. Texas

Tax Code Ann. § 151.052 (d) A printer is relieved of the obligation of collecting the taxes imposed by this chapter on printed materials that are distributed by the United States Postal Service singly or in sets addressed to individual recipients, other than the purchaser. The printer is required to collect Texas tax on these materials unless the purchaser issues an exemption certificate to the printer. The certificate must contain the statement that the printed materials are for multistate use and that the purchaser agrees to pay all taxes to Texas that are due. The printer is also required to file a report with the state on such sales.

3. Tennessee

Law § 67-6-203 -- Property used, consumed, distributed or stored.

(a) A tax is levied at the rate of six percent (6%) of the cost price of each item or article of tangible personal property when the same is not sold but is used, consumed, distributed, or stored for use or consumption in this state; provided, that there shall be no duplication of the tax.

(b) A tax, which shall be paid by the distributor, is also levied at the rate set out in subsection (a) on the value of catalogues, advertising fliers, or other advertising publications distributed to residents of Tennessee; provided, that this tax shall not be duplicative of a sales or use tax otherwise collected on such publications. "Distributor" does shall not include the commercial printer or mailer of any such catalogues, advertising fliers, or other advertising publications; nor shall nexus to a taxpayer be established through a relationship with a commercial printer or mailer having a presence in Tennessee; nor shall the commercial printer or mailer have the obligation of collecting any such tax.



Printing Industries of America, Inc.

November 6, 2002

The Honorable Matthew Kisber
State Representative
Tennessee House of Representatives
33 Legislative Plaza
Nashville, TN 37243-0173

The Honorable R. Bruce Johnson
Utah State Tax Commission
210 N 1950 West
Salt Lake City, UT 84134

Re: Sourcing Rules for Direct Mail

Dear Gentlemen:

This letter is in support of the proposed sourcing of direct mail that will be voted on at the upcoming Implementing States meeting in Chicago on November 12th. The Streamlined Sales Tax Project (the Project) unanimously approved this modification during its conference call on October 31, 2002. We believe that this provision is vital to the printing industry and represents a workable solution both to the states and to the consumers of direct mail.

Background

Direct mail relates to printed items that are sent to individual recipients at no charge, typically through the US Postal system. The recipients are designees of the printer's customer. Common direct mail items include catalogues, brochures and various forms of targeted communications.

The taxation of direct mail under the current sourcing rules would present a challenge to even the largest printers in the country. Sourcing on a ship-to basis is very difficult as the mailing lists used to print/image address labels are highly confidential and proprietary, and printing customers mandate that these lists be returned or destroyed after the printing job is complete. Therefore, even if the printers *could* extract the necessary data from these lists, they would have nothing in their files to support their determination of sales tax during a subsequent sales tax audit. Additionally, printers are sometimes provided pre-printed address labels for a printing job, and in such cases have no feasible way to determine sales tax on a destination basis.

The amount of time spent determining sales tax on a destination basis is extremely burdensome for printers, and is often disproportionate to the amount of tax involved. For example, the sales tax due to each state on a \$10,000 direct mail invoice would average around \$15; the amounts due to each city and county would be mere pennies.

Proposal

Several of the larger printers in the industry have been working with the Project's Sourcing Workgroup to develop reasonable rules for the collection of sales/use tax on direct mail. These efforts culminated in the following hierarchy of direct mail sourcing rules that will be presented to the Implementing States for adoption:

1. Customers can give the printer a direct mail exemption form (essentially, a special purpose direct pay permit) and self-assess use tax directly in each of the applicable jurisdictions on a destination basis. The printer is thus relieved of any obligation to collect sales/use tax.

2. Customers can give the printer a distribution list (e.g., the mailing list with the names deleted) so that the printer can use it to collect sales/use tax in all of the applicable jurisdictions on a destination basis. The customer would have to allow the printer to retain this distribution list with its records, and the states would have to accept the list's validity upon an audit of the printer.
3. If the printer's customer provides neither a direct mail exemption form nor a distribution list, then the printer is obligated to collect tax on the entire invoice based upon the location of the facility from which the material was shipped (i.e., "ship-from" basis). This default methodology would not eliminate the customer's obligation to self-assess use tax in each of the destination jurisdictions. The tax paid to the "ship-from" state may or may not be creditable towards the tax due to the destination state (printers and their customers obviously prefer that the tax be creditable). The Project's intention is to make Alternatives 1 and 2 mandatory. Consequently, the default rule (Alternative 3) is intentionally less favorable to the customer.

Summary

We encourage the Implementing States to adopt the modification to the sourcing rules for direct mail. Without this provision, small to medium-sized printers would have difficulty handling the multi-state taxation of direct mail, which could prevent them from registering with the Project. If adopted by the Implementing States, we believe that these rules would provide a much-needed measure of simplification to the printing industry, while maintaining the overall integrity and fairness of the taxation of direct mail. The Project states believe that these rules are beneficial, as evidenced by their unanimous adoption of the proposal last week.

Respectfully yours,



Benjamin Y. Cooper
Executive Vice President/Public Affairs
Printing Industries of America, Inc.

cc: Diane Hardt, Administrator, Division of Income, Sales & Excise, Wisconsin Department of Revenue
Bill Riesenberger, Legal Counsel, Technical, Sales & Use Tax Division, Ohio Dept. of Taxation
Thacher Smith, Vice President – Taxes, Wallace Computer Services, Inc.
Vytenis Kirvelaitis, Manager, State and Local Taxes, RR Donnelley & Sons Company
Gale Lawler, President, PrintTax Services

No More *Dilworth* Formalism After *Wayfair*

by Richard L. Cram



Richard L. Cram

Richard Cram is the director of the Multistate Tax Commission's National Nexus Program in Washington, D.C. Before that, Richard served as the director of policy and research in the Kansas Department of Revenue.

In this article, Cram discusses the 1944 sales tax decision of *McLeod v. Dilworth*, which held that a state could not impose a sales tax collection duty on an out-of-state seller using sales representatives to solicit interstate sales into that state, although the decision acknowledged that a state could impose a use tax collection duty on such a seller in similar circumstances. *South Dakota v. Wayfair*, in overruling the physical presence rule of *Quill* and *National Bellas Hess*, considered South Dakota's economic nexus statute that imposed a sales tax collection duty on the remote seller. Cram argues that because *Dilworth* was implicitly overruled in *Complete Auto Transit Inc. v. Brady*, states may impose either a use tax or a sales tax collection duty on a remote seller that has exceeded the state's economic nexus threshold, even though *Dilworth* was not raised in *Wayfair*.

The author thanks the following people for their very helpful comments and suggestions regarding this article: Michael Fatale, deputy general counsel, Massachusetts Department of Revenue; David Fruchtmann, partner, Steptoe & Johnson LLP; MTC General Counsel Helen Hecht; Scott Peterson, vice president of government relations, Avalara; and David Wiest, deputy secretary, South Dakota DOR.

In overturning the *Quill*¹ physical presence rule, *South Dakota v. Wayfair*² determined that a remote seller³ can be required to remit sales tax based on its economic nexus with the state. Under the statute at issue, South Dakota Codified Law (SDCL) section 10-64-2, a remote seller of tangible personal property, electronically transferred products, or services for delivery into South Dakota is required to remit the state's sales tax "as if the seller had a physical presence in the state," if the seller's gross revenue from those sales exceeded \$100,000 or it had 200 or more transactions in the current or previous calendar year.

The U.S. Supreme Court did not rule on the constitutionality of SDCL section 10-64-2, remanding the case back to the South Dakota Supreme Court for that purpose.⁴ The case was thereafter settled, so no constitutionality ruling was made.⁵ After *Wayfair*, a business's in-state physical presence is no longer constitutionally required to determine commerce clause substantial nexus. Therefore, a state can obligate a remote seller to collect its sales or use tax if the seller's economic or virtual presence provides substantial nexus.⁶

¹ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

² 585 U.S. ___, 138 S. Ct. 2080 (2018).

³ In this article, "remote seller" refers to an out-of-state seller with no physical presence in the taxing state.

⁴ 138 S. Ct. at 2099-2100.

⁵ See *South Dakota v. Wayfair*, No 32 Civ 16-92, Circuit Court of Sixth Judicial Circuit, Settlement Agreement and Stipulation of Dismissal (Oct. 31, 2018).

⁶ 138 S. Ct. at 2099.

Some have noted that SDCL section 10-64-2 concerned the remote seller's obligation to remit sales tax, not use tax.⁷ They further note that *Quill* and *National Bellas Hess*,⁸ the decisions overruled in *Wayfair*, both concerned the constitutionality of an obligation imposed on the remote seller to collect use tax, not sales tax.⁹ Therefore, they conclude that there is still doubt as to whether a state can impose a sales tax collection obligation on a remote seller, although neither the taxpayers nor the Court expressly raised or addressed this distinction in *Wayfair*.¹⁰

Professors David Gamage, Darien Shanske, and Adam Thimmesch point to the "sales tax formalism" created by a 1944 sales tax decision, *McLeod v. Dilworth*.¹¹ That decision held that Arkansas could not impose its sales tax on a Tennessee seller delivering product from Tennessee by common carrier to customers in Arkansas, although sales representatives of the seller solicited orders in Arkansas. *Dilworth* considered the sale to be consummated in Tennessee, so the Arkansas sales tax could not reach the transaction.¹² The professors identify a companion decision, *General Trading Co. v. Iowa*,¹³ which authorized Iowa to impose a use tax collection duty on an out-of-state seller using sales representatives to solicit sales in Iowa.¹⁴ Under the *Dilworth* formalism, a state could impose a use tax collection duty on an out-of-state seller shipping merchandise into the state and using sales representatives in the state — but not a sales tax collection duty.

The professors note that *Wayfair* did not explicitly overrule *Dilworth*.¹⁵ In view of that, they recommend that states enacting economic nexus provisions under *Wayfair* should "continue to abide by the *Dilworth* formalism and . . . enact their economic nexus standards through their use tax systems."¹⁶ For states wishing to follow the South Dakota model, the professors recommend that those states "ensure that their statutes impose the tax [on interstate sales] as a substantive matter."¹⁷

Professor Richard Pomp concurs that states considering adoption of economic nexus laws should draft them to impose on the remote seller the obligation to collect use tax, not sales tax.¹⁸ However, he disagrees that South Dakota statutes should serve as a model.¹⁹ Pomp warns that under *Dilworth*,²⁰ a state's attempt to impose sales tax on a transaction crossing state borders may still be unconstitutional, although imposing a use tax collection obligation on such a transaction has long been sanctioned.²¹

Well before *Wayfair*, professor John A. Swain pointed out that under the contemporary commerce clause analysis of *Complete Auto Transit Inc. v. Brady*,²² this "triumph of formalism"²³ in *Dilworth* has effectively been overruled.²⁴ He contended that a properly drawn sales tax statute would bring interstate sales within constitutional reach of the state's tax collection authority.²⁵ Swain suggested that it should be constitutionally

⁷ See, e.g., David Gamage, Darien Shanske, and Adam Thimmesch, "Wayfair: Sales Tax Formalism and Income Tax Nexus," *Tax Notes State*, Sept. 3, 2018, p. 975; and Richard D. Pomp, "Wayfair: Its Implications and Missed Opportunities," *Tax Notes State*, Apr. 2, 2019, p. 1035.

⁸ *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967).

⁹ Pomp, *supra* note 7, at 1060. *National Bellas Hess* considered the constitutionality of imposing the use tax collection obligation in Ill. Rev. Stat. c. 120, section 439.3 (1965) on the remote seller. *Quill* considered the constitutionality of imposing a similar use tax collection obligation on the remote seller in N.D. Cent. Code section 57-40.2-07 (Supp. 1991).

¹⁰ Gamage, Shanske, and Thimmesch, *supra* note 7, at 976; Pomp, *supra* note 7, at 1060-1063.

¹¹ 322 U.S. 327 (1944).

¹² *Id.* at 330.

¹³ 322 U.S. 335 (1944).

¹⁴ Gamage, Shanske, and Thimmesch, *supra* note 7, at 975; Pomp, *supra* note 7, at 1060.

¹⁵ Gamage, Shanske, and Thimmesch, *supra* note 7, at 976.

¹⁶ *Id.*

¹⁷ *Id.*, citing SDCL sections 10-45-2, 10-45-108; S.D. Admin. R. section 64:06:01:62(1); and Streamlined Sales and Use Tax Agreement sections 310-311.

¹⁸ Pomp, *supra* note 7, at 1060.

¹⁹ *Id.* at 1063.

²⁰ *Id.* at 1061, discussing *McLeod v. Dilworth*, 322 U.S. 327 (1944).

²¹ *Id.*, discussing *General Trading*.

²² 430 U.S. 274 (1977).

²³ *Id.* at 281 (in reference to the rule in *Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951) and *Freeman v. Hewitt*, 329 U.S. 249 (1946) that a state tax on the "privilege of doing business" is per se unconstitutional when applied to interstate commerce, overruled in *Complete Auto*).

²⁴ John A. Swain, "The Zombie Precedent: *Norton Co. v. Department of Revenue*," *Tax Notes State*, Apr. 17, 2017, p. 301, at n. 8 (citing *Complete Auto*, 430 U.S. at 281).

²⁵ *Id.*; see Swain, "The Sales and Use Tax Dichotomy and the Streamlining Movement," *Tax Notes State*, Jan. 15, 2007, p. 129.

permissible to merge the sales and use tax concepts.²⁶

Does the *Dilworth* formalism remain alive even after *Wayfair* as a “trap for the unwary draftsman,”²⁷ potentially invalidating a state’s imposition on the remote seller of a sales tax collection duty?

If the state’s sales tax imposition statute is properly drafted to reach interstate sales, a remote seller’s collection duty should not be invalid simply because it applies to sales tax instead of use tax. *Wayfair*’s failure to specifically address this question or expressly overrule *Dilworth* is most likely due not only to the fact that the taxpayers did not raise the issue, but also because the Court agreed that such formalism had been abandoned. This article explains why the *Dilworth* formalism is gone, describing briefly the sales and use tax structure and how the Court’s understanding in *Wayfair* of the states’ sales and use tax systems signals indifference to that formalism.

This article will show that South Dakota’s sales tax laws are properly drafted to reach interstate sales. Second, U.S. Supreme Court decisions leading up to and including *Dilworth* reveal that the *Dilworth* formalism rested on the state court’s interpretation that the subject sales were consummated out of state, as well as the “free trade” rule.²⁸ Under this now discredited rule, the commerce clause immunized from state taxation transactions in interstate commerce. Strong dissents in *Dilworth* questioned the validity of that formalism. Third, *Complete Auto*

rejected the free trade rule and adopted a four-part test for evaluating state taxation of interstate commerce, invalidating the *Dilworth* formalism.

Finally, *Wayfair* determined that the South Dakota sales tax was lawfully imposed on interstate transactions, with the sale being consummated upon delivery of the purchased product in the state. *Wayfair* recognized that the case concerned a remote vendor’s sales tax remittance obligation, not a use tax collection obligation, but remained indifferent to that distinction. *Wayfair* did not need to explicitly overrule the *Dilworth* formalism, because that formalism is a direct offshoot of a long-discredited view of the commerce clause.

South Dakota Sales and Use Tax Statutes

Sales tax and use tax are complementary yet different taxes. Sales tax functions as a consumption tax paid by the consumer.²⁹ States impose the sales tax on the transaction as a fixed percentage of the sales price in the retail sale of tangible personal property, some enumerated services, or digital products, to the extent included in the tax base.³⁰

The seller collects the sales tax from the purchaser at the time of the transaction, and periodically remits it to the state, along with a sales tax return.³¹ The seller remains liable to remit the sales tax, whether collected from the purchaser or not.³²

The sales tax is triggered by consummation of the sale, which under South Dakota law occurs upon delivery of the product to the purchaser in

²⁶ *Id.* at 131-132. Swain also warned that several legislative changes would be needed to accomplish that, such as making the sales tax base and use tax base uniform; sourcing sales to the destination, a proxy for where consumption takes place; and employing a seller collection mechanism, but recognizing that situations exist when consumer remittances need to be reconciled with seller remittances and credits allowed to prevent double taxation. These situations may include the purchaser making taxable use of an item in a jurisdiction other than the delivery jurisdiction, the purchaser claiming an exemption at the time of purchase but later making a taxable use of the item, or the purchaser providing a direct pay permit to the seller. *Id.*

In the case of software or remote access to software purchases, the item or service could be used in multiple jurisdictions. Also, use tax revenues may be dedicated to funding different governmental purposes than sales tax revenues, so merging would present tracking difficulties. The mechanics of merging sales and use tax are beyond the scope of this article, although certainly a topic worthy of further investigation.

²⁷ 430 U.S. at 281.

²⁸ See *Spector* and earlier cases embodying the rule cited in 430 U.S. at 279, n. 9.

²⁹ Jerome R. Hellerstein and Walter Hellerstein, *State and Local Taxation* (7th ed., 2001), at 836.

³⁰ SDCL sections 10-45-2, 10-45-2.4, 10-45-5.2 impose sales tax directly on the seller for the privilege of engaging in retail sales of tangible personal property, some services, and products transferred electronically.

³¹ Under South Dakota law, the seller has the right to collect the sales tax from the purchaser but no obligation to do so. SDCL section 10-45-22. Some states (“vendor tax” states), like South Dakota, impose the sales tax directly on the seller, while other states (“consumer tax” states) impose the sales tax on the purchaser, with an obligation on the seller to collect it. Still other states (“hybrid tax” states) may combine the features of both in their tax. See John F. Due and John L. Mikesell, *Sales Taxation* (2nd ed., 1994), at 28-29; and Walter Nagel, “State Business Taxes,” *Law Journal Press* (2012), section 4.01, at 4-4.

³² SDCL section 10-45-27.3. Wherever the legal incidence may lie, the economic incidence of the tax is viewed as resting upon the consumer. Hellerstein and Hellerstein, *supra* note 29, at 662.

the state.³³ South Dakota sources the sale to the destination where the purchaser receives the product (referred to as “destination sourcing”).³⁴ Under South Dakota administrative rules, sales tax is imposed on transactions originating outside the state when the seller ships the product from outside the state to the purchaser in the state, the product is for use or consumption in the state, and the seller “engages in business” in the state.³⁵ Also, South Dakota law requires remote retailers to remit sales tax on their sales into South Dakota exceeding the state’s economic nexus threshold.³⁶ Administrative rules also provide that if the sale originates in South Dakota, but the item is shipped out of state to the purchaser, then it is not considered a South Dakota sale and is not subject to the state’s sales tax.³⁷

The use tax complements the sales tax, discouraging purchasers from attempting to avoid the tax by buying items out of state rather than from in-state sellers. The use tax is also considered “compensatory” with the sales tax.³⁸ The use tax rate mirrors the sales tax rate and is imposed on the consumer for the “use, storage, or consumption” of tangible personal property, enumerated services, or digital products (depending on the scope of the state or local use tax base, which may be equal to or narrower than the corresponding sales tax base³⁹) in the taxing state.⁴⁰ The use tax applies when the consumer has not paid sales tax on the purchase. The taxpayer receives credit against the use tax for any other

state’s sales or use tax paid on the purchase transaction, up to the amount of use tax due.⁴¹ The credit protects against multiple states imposing sales or use taxes on the same transaction.

Although the use tax is imposed on the consumer, the state may impose a collection obligation on the seller when it is “maintaining a place of business in this state.”⁴² If the seller does not collect the use tax, the consumer remains liable to the administering state tax agency for the tax.⁴³ States have recognized that use tax collection by the vendor at the time of the transaction is the most effective means of tax compliance.⁴⁴ However, as will be discussed later, South Dakota relied on its remote vendor sales tax remittance statute — not its use tax collection statute — in *Wayfair*.

Use Tax Cases

The use tax received constitutional approval in *Henneford v. Silas Mason Co.*⁴⁵ Washington imposed use tax on tangible personal property used in the state and bought at retail outside the state, with no sales tax having been paid. The Washington Tax Commission notified specific contractors and subcontractors on the Grand Coulee Dam construction project that use tax was due on their equipment, materials, and supplies purchased at retail outside the state, brought into the state for use, and on which no Washington sales tax had been paid. The taxpayers challenged the tax under the commerce clause as a “tax upon the operations of interstate commerce or a discrimination against such commerce obstructing or burdening it unlawfully.”⁴⁶ *Henneford* upheld the use tax as constitutional, “not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end.”⁴⁷ *Henneford* observed:

³³ SDCL section 10-64-2. States generally follow the “destination rule” for sourcing sales tax. See Nagel, *supra* note 31, section 4.01, at 4-5.

³⁴ SDCL section 10-45-108.

³⁵ South Dakota Administrative Rule 64:06:01:25; see SDCL section 10-45-2.

³⁶ SDCL section 10-64-2.

³⁷ South Dakota Administrative Rule 64:06:01:24; see SDCL section 10-45-108.

³⁸ See *Associated Industries of Missouri v. Lohman*, 511 U.S. 641, 647 (1994) (“Under the compensatory tax doctrine, a facially discriminatory tax that imposes on interstate commerce the equivalent of an ‘identifiable and substantially similar tax on intrastate commerce does not offend the negative Commerce Clause.’” [Citation omitted]).

³⁹ Swain observed that in some states, the use tax applies only to tangible personal property and not services. “The Sales and Use Tax Dichotomy and the Streamlining Movement,” *supra* note 25, at 132. Also, use tax may be imposed at the state — but not local — level in some states.

⁴⁰ See SDCL sections 10-46-2, 10-46-2.1, 10-46-2.2, 10-46-4 for South Dakota’s imposition of use tax on the consumer for the use, storage, and consumption in the state of tangible personal property, services and products transferred electronically.

⁴¹ SDCL section 10-46-34.1. South Dakota requires that the other state provide a reciprocal credit.

⁴² SDCL sections 10-46-1 (12); 10-46-20; 10-46-23.

⁴³ SDCL section 10-46-33.

⁴⁴ 138 S. Ct. at 2088.

⁴⁵ 300 U.S. 577 (1937).

⁴⁶ 300 U.S. at 581.

⁴⁷ *Id.*

One of [the use tax's] effects must be that retail sellers in Washington will be helped to compete upon terms of equality with retail dealers in other states who are exempt from a sales tax or any corresponding burden. Another effect, or at least another tendency, must be to avoid the likelihood of a drain upon the revenues of the state, buyers being no longer tempted to place their orders in other states in the effort to escape payment of the tax on local sales.⁴⁸

Henneford characterized the Washington use tax as a property tax that is “non-discriminatory in its operation” when the properties acquired or transported in interstate commerce “have become part of the common mass of property within the state of destination.”⁴⁹ The Court also noted the use tax’s credit feature: “Every one who has paid a use or sales tax anywhere, or, more accurately, in any state, is to that extent to be exempt from the payment of another tax in Washington.”⁵⁰ The in-state purchaser and the out-of-state purchaser are treated equally: One pays the sales tax, while the other pays a complimentary use tax — both at the same rate. However, the Court did not consider the credit feature as necessarily required for constitutional purposes.⁵¹

Henneford concerned the consumer’s direct liability for use tax. Later cases upheld states’ authority to impose a use tax collection duty on the seller.

In *Felt & Tarrant Co. v. Gallagher*,⁵² an Illinois manufacturer sold its products to customers in California, using sales agents to solicit orders. The manufacturer rented office space for the sales agents in California and approved the hiring of any subagents hired by those agents. For accepted orders, the manufacturer shipped the products directly to California purchasers, or to the sales agents in California, who then delivered them to purchasers. California sought to impose its use tax collection obligation on the

manufacturer, as a retailer “maintaining a place of business” in the state. Relying on *Henneford*, the Court upheld imposition of California’s use tax collection obligation on the manufacturer.⁵³

*Nelson v. Sears, Roebuck & Co.*⁵⁴ and *Nelson v. Montgomery Ward & Co.*⁵⁵ upheld Iowa’s use tax statute imposing a collection duty on retailers “maintaining a place of business” in the state. Iowa sought use tax from Sears and Montgomery Ward on their mail order sales to Iowa customers. Sears and Montgomery Ward conducted their mail order sales from locations outside Iowa, but also maintained retail stores in Iowa. Although Sears and Montgomery Ward collected and remitted Iowa sales tax on sales made or orders taken at their retail stores in Iowa, they did not collect any tax on the mail order sales to Iowa customers. Relying in part on *Henneford*, the Court upheld the Iowa use tax collection obligation imposed on the sellers.⁵⁶

*General Trading Co. v. Iowa*⁵⁷ upheld imposing Iowa’s use tax collection obligation on the seller located outside the state and using sales representatives to solicit orders from customers in Iowa. The seller had no stores or facilities in Iowa — only sales representatives.

Sales Tax Cases

In *McGoldrick v. Berwind-White Coal Mining Co.*,⁵⁸ New York City applied its sales tax on “consumption of tangible personal property”⁵⁹ to a Pennsylvania coal manufacturer’s sale of coal to consumers and dealers in New York City. The coal was mined in Pennsylvania, shipped to a Jersey City, New Jersey, dock, and then delivered by the coal manufacturer via barge to the New York City purchasers. The coal manufacturer maintained an office in New York City — at which it entered into contracts with its customers providing for the purchase and delivery of coal.

⁴⁸ *Id.*

⁴⁹ *Id.* at 582-583 (citations omitted).

⁵⁰ *Id.* at 583.

⁵¹ *Id.* at 587.

⁵² 306 U.S. 62 (1939).

⁵³ *Id.* at 67.

⁵⁴ 312 U.S. 359 (1941).

⁵⁵ 312 U.S. 373 (1941).

⁵⁶ 312 U.S. at 363.

⁵⁷ 322 U.S. 335 (1944).

⁵⁸ 309 U.S. 33 (1940).

⁵⁹ 309 U.S. at 42.

The coal manufacturer challenged the sales tax as a violation of the commerce clause. The New York Supreme Court agreed,⁶⁰ and the New York Court of Appeals affirmed.⁶¹ The state courts had construed the sales tax imposition statute as conditioning the tax on the transfer of possession or title to the purchaser occurring in the state, or consummation of the agreement for the transfer of possession or title occurring within the state.⁶² The U.S. Supreme Court reversed in a 6-3 decision. The majority opinion (delivered by Justice Harlan Stone) upheld the tax, observing:

Its only relation to the commerce arises from the fact that immediately preceding transfer of possession to the purchaser within the state, which is the taxable event regardless of the time and place of passing title, the merchandise has been transported in interstate commerce and brought to its journey's end. Such a tax has no different effect upon interstate commerce than a tax on the "use" of property which has just been moved in interstate commerce.⁶³

The majority opinion further stated:

We can find no adequate basis for distinguishing the present tax laid on the sale or purchase of goods upon their arrival at destination at the end of an interstate journey from the tax which may be laid in like fashion on the property itself.⁶⁴

Interpreting the New York City sales tax imposition statute consistently with the state courts, the *Berwind-White Coal Mining Co.* majority viewed the sales transactions as consummated at the place of delivery of the coal to the purchasers for consumption in New York City: destination sourcing.⁶⁵ The majority emphasized that "the

object of interstate shipment is a sale at destination."⁶⁶

Chief Justice Charles Evans Hughes's dissenting opinion (joined by Justices James Clark McReynolds and Owen Roberts) characterized the coal transactions at issue as "interstate commerce in its most obvious form"⁶⁷ — with the seller in Pennsylvania and the purchasers in New York City. The coal was mined in Pennsylvania, shipped from there, and delivered to the purchasers in New York City — with the tax imposed directly on the seller and "laid upon interstate sales."⁶⁸ The dissent disagreed that delivery of the coal to the customer in New York City constituted the "taxable event within the state,"⁶⁹ viewing delivery as only part of the interstate transaction, and finding "no ground for sustaining a tax upon the whole of the interstate transaction of which the delivery is only a part, as in the case of a tax upon the entire gross receipts."⁷⁰

McGoldrick v. Felt & Tarrant Manufacturing Co. was a companion case to *Berwind-White Coal Mining Co.*, with which it also shared an identical 6-3 split among the justices. The facts mirrored those in *Felt & Tarrant Manufacturing Co. v. Gallagher*, only New York City was the taxing jurisdiction rather than California. The Illinois manufacturer maintained a New York City office from which its agents solicited sales and took orders, sending those to the home office for acceptance. The manufacturer shipped ordered product to its New York City sales office, and the sales agents delivered the product to customers in the city. The manufacturer also shipped product directly to New York City customers from Illinois. New York City applied its sales tax to those transactions, seeking liability from the manufacturer, which challenged the tax as a violation of the commerce clause. Relying on *Berwind-White Coal Mining Co.*, the Court upheld application of the New York City sales tax on those transactions, noting that the orders were

⁶⁰ 255 App. Div. 961; 8 N. Y. S. 2d 668.

⁶¹ 309 U.S. at 41 (citing 281 N. Y. 610).

⁶² 309 U.S. at 42.

⁶³ 309 U.S. at 49 (citing *Henneford v. Silas Mason Co., Felt & Tarrant Manufacturing Co. v. Gallagher*, among other cases).

⁶⁴ *Id.* at 52.

⁶⁵ *Id.* at 43-44, 59. ("Here the tax is conditioned upon a local activity, delivery of goods within the state upon their purchase for consumption." *Id.* at 59).

⁶⁶ *Id.* at 54.

⁶⁷ *Id.* at 59.

⁶⁸ *Id.* at 60.

⁶⁹ *Id.* at 64.

⁷⁰ *Id.* at 65.

taken in the city, and that the merchandise was delivered to customers there.⁷¹

Dilworth considered the validity under the commerce clause of imposing the Arkansas sales tax on a Tennessee vendor making retail sales to customers in Arkansas. The seller's sales representatives solicited orders in Arkansas. The retailer accepted in Tennessee orders from Arkansas customers by mail and telephone, and also transferred the merchandise to a common carrier in Tennessee for ultimate delivery to the Arkansas purchasers. The Arkansas revenue commissioner filed suit against the vendor, seeking tax on the transactions. The seller challenged the tax as violating the commerce clause and due process. The Chancery Court ruled for the seller, dismissing the suit, and the Arkansas Supreme Court affirmed,⁷² interpreting the tax imposition statute as a sales tax and determining that the sales took place in Tennessee, based upon title transferring from the retailer upon delivery of product to the common carrier. The U.S. Supreme Court affirmed in a 5-4 decision.⁷³

The *Dilworth* majority opinion, consistent with the Arkansas Supreme Court's interpretation of Arkansas law, viewed the sales transactions at issue as occurring in Tennessee, not Arkansas, so Arkansas could not impose its sales tax on them:

In this case the Tennessee seller was through selling in Tennessee. We would have to destroy both business and legal notions to deny that under these circumstances the sale — the transfer of ownership — was made in Tennessee. For Arkansas to impose a tax on such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction.⁷⁴

The *Dilworth* majority opinion acknowledged that Arkansas could have imposed a use tax collection duty on the seller.⁷⁵ In contrast to the

Berwind-White Coal Mining Co. majority opinion, the *Dilworth* majority opinion drew a sharp distinction between a sales tax on an interstate sale and a use tax for purposes of commerce clause analysis:

Arkansas has chosen not to impose such a use tax, as its Supreme Court so emphatically found. A sales tax and a use tax in many instances may bring about the same result. But they are different in conception, are assessments upon different transactions, and in the interlacings of the two legislative authorities within our federation may have to justify themselves on different constitutional grounds. A sales tax is a tax on the freedom of purchase — a freedom which wartime restrictions serve to emphasize. A use tax is a tax on the enjoyment of that which was purchased. In view of the differences in the basis of these two taxes and the differences in the relation of the taxing state to them, a tax on an interstate sale like the one before us and unlike the tax on the enjoyment of the goods sold, involves an assumption of power by a State which the Commerce Clause was meant to end.⁷⁶

...

Though sales and use taxes may secure the same revenues and serve complementary purposes, they are, as we have indicated, taxes on different transactions and for different opportunities afforded by a State.⁷⁷

In reaching its determination, the *Dilworth* majority opinion distinguished the earlier sales tax cases, *Berwind-White Coal Mining Co.*⁷⁸ and *McGoldrick v. Felt & Tarrant Manufacturing Co.*⁷⁹

The *Dilworth* majority opinion found "relevant and controlling" the factual differences identified by the Arkansas Supreme Court

⁷¹ 309 U.S. at 77.

⁷² 205 Ark. 780, 171 S.W.2d 62 (1943), relying on *Mann v. Carroll*, 198 Ark. 628, 130 S. W. 2d 721 (1939).

⁷³ 322 U.S. at 332.

⁷⁴ *Id.* at 329.

⁷⁵ *Id.* at 330.

⁷⁶ *Id.*

⁷⁷ *Id.* at 331.

⁷⁸ 309 U.S. 33 (1940).

⁷⁹ 309 U.S. 70 (1940).

between the case at hand and *Berwind-White Coal Mining Co.*: The out-of-state seller in *Berwind-White Coal Mining Co.* maintained its sales office in New York City, took its contracts there, and made actual delivery in the city. These activities constituted retail sales in New York City.⁸⁰ In *Dilworth*, the majority opinion determined that the seller maintained offices in Tennessee and made the sale there, consummating the sale with delivery in the state or in interstate commerce to the carrier.⁸¹

Justice William Douglas's dissent in *Dilworth* (with Justices Hugo Black and Frank Murphy concurring) saw no distinction between a destination-sourced sales tax on an interstate sale and a use tax, for purposes of commerce clause analysis:

But a use tax and a sales tax applied at the very end of an interstate transaction have precisely the same economic incidence. Their effect on interstate commerce is identical.⁸²

...

In terms of state power, receipt of goods within the State of the buyer is as adequate a basis for the exercise of the taxing power as use within the State. And there should be no difference in result under the Commerce Clause where, as here, the practical impact on the interstate transaction is the same.⁸³

Similarly, Justice Wiley Blount Rutledge's dissent⁸⁴ in *Dilworth* compared the facts with those in the companion decision of *General Trading Co.*, finding "no difference but one of words" for "constitutional purposes,"⁸⁵ and concluding that "it is hard to see how one tax can be upheld and the other voided."⁸⁶ Application of the Arkansas sales tax to the out-of-state seller using agents to

solicit sales in Arkansas was held invalid in *Dilworth*, while application of the Iowa use tax collection obligation to the remote retailer using agents to solicit sales in Iowa was upheld in *General Trading Co.* His dissent added: "Other things being the same, constitutionality should not turn on whether one name [for the tax] or the other is applied by the state."⁸⁷

Rutledge found sufficient due process connections with Arkansas, the market state, to sustain the tax:

Thus, in the case from Arkansas . . . should there be [no] difficulty in finding due process connections with the taxing state sufficient to sustain the tax. . . . [T]he goods are sold and shipped to Arkansas buyers. Arkansas is the consuming state, the market these goods seek and find. They find it by virtue of a continuous course of solicitation there by the Tennessee seller.⁸⁸

Rutledge acknowledged that Tennessee, as the "origin state," would also have sufficient connections to tax the transaction, but that should not "deprive Arkansas of the same power."⁸⁹

Rutledge characterized the transaction at issue as "interstate," and suggested that because the commerce clause prohibits states from discriminating against interstate commerce, it should operate to prohibit both the origin state and market state from taxing that same interstate transaction. One of those taxes must give way. He clearly preferred giving priority to the market state's taxing authority:

If in this case it were necessary to choose between the state of origin and that of market for the exercise of exclusive power to tax, or for requiring allowance of credit in order to avoid the cumulative burden, in my opinion the choice should lie in favor of the state of market rather than the state of origin. The former is the state where the goods must come in competition with those sold locally. It is the one where the burden of the tax

⁸⁰ 322 U.S. at 329.

⁸¹ *Id.*

⁸² *Id.* at 333.

⁸³ *Id.* at 334.

⁸⁴ *International Harvester Co. v. Department of Treasury*, 322 U.S. 340, 349 (1944).

⁸⁵ *Id.* at 350.

⁸⁶ *Id.* at 351.

⁸⁷ *Id.*

⁸⁸ *Id.* at 353-354.

⁸⁹ *Id.* at 357.

necessarily will fall equally on both classes of trade.⁹⁰

Rutledge acknowledged the commerce clause risk of double taxation when both the origin state and destination state could attempt to tax the interstate sales transaction:

If in each case the state of origin were shown to impose a sales tax of three per cent and the state of market a use tax of the same amount, interstate transactions between the two obviously would bear double the local tax burden borne by local trade in each state.⁹¹

But Rutledge doubted “that the mere risk Tennessee may apply its taxing power to these transactions will have any substantial effect in restraining the commerce such as the actual application of that power would have.”⁹²

At the time of *Dilworth*, interstate commerce was deemed immune from state taxation under the so-called “free trade” rule:

The very purpose of the Commerce Clause was to create an area of free trade among the several States. That clause vested the power of taxing a transaction forming an unbroken process of interstate commerce in the Congress, not in the States.⁹³

If the tax was found to apply to transactions considered to be in interstate commerce (such as application of the Arkansas sales tax at issue in *Dilworth*), then it violated the commerce clause. If the tax applied at the point after interstate commerce had ended (such as application of the New York City sales tax at issue in *Berwind-White Coal Mining Co.* to the point of delivery), then it did not violate the commerce clause. Thus, determination of whether the tax at issue was applied to a “local event” or to interstate commerce was critical to its validity under the commerce clause.

The following two decisions, citing *Dilworth*, applied the free trade rule to invalidate state

taxes: *Freeman v. Hewit*,⁹⁴ (holding unconstitutional Indiana’s gross receipts tax as applied to the proceeds of securities sold on the New York Exchange for an Indiana broker on behalf of an Indiana trust) and *Spector Motor Service Inc. v. O’Connor*⁹⁵ (a 5-3 decision holding unconstitutional a Connecticut corporate income tax on the “privilege of doing business” imposed on a Missouri-incorporated multistate trucking company hauling product into and out of Connecticut). *Hewit* noted the precedent for states lawfully imposing consumption taxes on goods from out of state.⁹⁶ *Hewit* also distinguished the permissible “local” sales tax at issue in *Berwind-White Coal Mining Co.* from the impermissible direct sales tax on interstate commerce in *Dilworth*. Then, *Hewit* essentially articulated the *Dilworth* formalism as follows: “Taxes which have the same effect as consumption taxes are properly differentiated from a direct imposition on interstate commerce.”⁹⁷

Relying on *Hewit* as well as *Dilworth* and acknowledging that a state may appropriately impose a tax “as compensation for petitioner’s use of the highways,” the *Spector* majority opinion determined that the Connecticut tax violated the free trade rule as a tax placed on the “corporation’s franchise for the privilege of carrying on exclusively interstate transportation in the State.”⁹⁸ The opinion stated the *Dilworth* formalism in another way:

Even though the financial burden on interstate commerce might be the same, the question whether a state may validly make interstate commerce pay its way depends first of all upon the constitutional channel through which it attempts to do so.⁹⁹

The *Spector* majority opinion’s use of the free trade rule to compare a lawful tax on in-state highway use with a constitutionally barred direct

⁹⁰ *Id.* at 361.

⁹¹ *Id.* at 359.

⁹² *Id.* at 362.

⁹³ 322 U.S. at 330-331.

⁹⁴ 329 U.S. 249, 257 (1946).

⁹⁵ 340 U.S. 602, 608 (1951).

⁹⁶ 329 U.S. at 257.

⁹⁷ *Id.*

⁹⁸ 340 U.S. at 68

⁹⁹ *Id.*

tax on interstate transportation matches up well with the *Dilworth* formalism's comparison of a lawful use tax on out-of-state goods with the unlawful direct sales tax on interstate commerce.

In addition to the free trade rule, the *Dilworth* formalism also rested on the Arkansas Supreme Court's interpretation of Arkansas tax law that the sales transaction on which the tax was imposed was deemed consummated out of state. As noted, in *Berwind-White Coal Mining Co.* the transaction subject to tax was deemed consummated at the location of delivery to the purchaser, New York City.

Complete Auto

The rule that interstate commerce had free trade immunity from state taxation under the commerce clause remained effective until *Complete Auto* discarded it.¹⁰⁰ *Complete Auto* upheld against a commerce clause challenge Mississippi's sales tax on the privilege of doing business in the state. The tax was imposed on a Michigan-incorporated motor carrier's gross receipts from transporting new vehicles shipped by rail from the out-of-state factory to the state and then delivered by the motor carrier to car dealers within the state. *Complete Auto* rejected the free trade rule embodied in *Spector*, overruling that decision.¹⁰¹ Although the Court extensively discussed *Hewitt* in connection with the free trade rule, that decision was not explicitly overruled.¹⁰²

The Court observed that decisions succeeding *Hewitt* narrowed the free trade rule, upholding state taxes on income generated in interstate commerce but disallowing taxes on the "privilege" of engaging in interstate commerce. By the time of the *Spector* decision, the free trade rule had become merely a rule of

"draftsmanship."¹⁰³ *Complete Auto* replaced the *Spector* rule with the four-part test under which a state can tax interstate commerce if the tax:

[1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.¹⁰⁴

After *Complete Auto*, the fictional determination of whether the tax applies to a sales transaction consummated either during or after interstate commerce has ended no longer has significance for commerce clause purposes.¹⁰⁵

Likewise, *Complete Auto*'s disposal of the free trade rule and replacement with the four-part test eliminated the need to distinguish between a destination-sourced sales tax imposed on a transaction in interstate commerce and a use tax imposed on the storage, use, or consumption of the purchased item after interstate commerce has ended. As Swain suggested,¹⁰⁶ after *Complete Auto*, states have the authority to impose sales tax on transactions in interstate commerce without regard to the *Dilworth* formalism. Subject to the *Complete Auto* four-part test, the commerce clause places no barrier against one state imposing a destination-based sales tax on a seller in another state. The imposition statute must, of course, source the sale to its destination and impose the tax on the point of delivery to the purchaser in the taxing state.¹⁰⁷ However, prior to *Wayfair* and

¹⁰³ 430 U.S. at 281-285, comparing *Memphis Gas Co. v. Stone*, 335 U.S. 80 (1948), upholding a Mississippi franchise tax imposed on the value of capital in a multistate pipeline going across the state, with *Spector*, finding unconstitutional a Connecticut tax on the "privilege of doing business" imposed on a Missouri-incorporated multistate trucking company hauling product into and out of Connecticut.

¹⁰⁴ *Id.* at 279.

¹⁰⁵ See Pomp, *supra* note 7, at 1061. Pomp contends that even after *Complete Auto*, the constitutional definition of where a sale takes place remains open.

¹⁰⁶ *Supra* note 24, at 301-302, n. 8.

¹⁰⁷ Pomp acknowledges that *Complete Auto* overturned that aspect of *Dilworth* relying on the free trade rule in *Spector* but contends that "still left open is the constitutional characterization of where a sale takes place." Pomp, *supra* note 7, at 1061. However, as previously discussed, *Dilworth* adopted the Arkansas Supreme Court's interpretation that under applicable state law, the transaction was consummated in Tennessee, whereas *Berwind-White Coal Mining Co.*, interpreting the sales tax imposition statute at issue, determined that the sale was consummated at the place of delivery to the purchaser. The location where a sale is deemed consummated appears to be a matter of statutory interpretation, not constitutional characterization.

¹⁰⁰ 430 U.S. 274, 288-89 (1977), overruling *Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951). See Pomp, *supra* note 7, at 1061, n. 208.

¹⁰¹ 430 U.S. at 289.

¹⁰² 430 U.S. at 274-275. But see *Quill*, 504 U.S. at 310:

Complete Auto rejected *Freeman* and *Spector*'s formal distinction between "direct" and "indirect" taxes on interstate commerce because that formalism allowed the validity of statutes to hinge on "legal terminology," "draftsmanship and phraseology." [Citation omitted.]

under *Quill*, the seller needed to have a physical presence in the taxing state before that state could impose any tax collection obligation.

Wayfair

Wayfair considered three large online retailers' constitutional challenge to South Dakota's newly enacted economic nexus law and, as noted, overruled the *Quill* physical presence rule. South Dakota's economic nexus statute imposed a sales tax remittance obligation on the remote seller — not a use tax collection obligation. None of the parties in *Wayfair* raised any issue concerning that fact.¹⁰⁸ Respondents Wayfair Inc., Overstock.com Inc., and Newegg Inc. were the parties likely to raise it, but probably concluded that the issue was not worth litigating. *Complete Auto* had disposed of it, along with the fact that the South Dakota sales tax law imposed the tax upon interstate sales with delivery in the state.

The Court recognized that South Dakota's sales tax law was at issue, and referenced the state's use tax laws only regarding consumer use tax liability:

Like most States, South Dakota has a sales tax. It taxes the retail sales of goods and services in the State. S. D. Codified Laws [sections] 10-45-2, 10-45-4 (2010 and Supp. 2017). Sellers are generally required to collect and remit this tax to the Department of Revenue. [Section] 10-45-27.3. If for some reason the sales tax is not remitted by the seller, then in-state consumers are separately responsible for paying a use tax at the same rate. See [sections] 10-46-2, 10-46-4, 10-46-6. Many States employ this kind of complementary sales and use tax regime.¹⁰⁹

¹⁰⁸ The amici curiae brief of Washington State Tax Practitioners submitted in *Wayfair* emphasized that South Dakota was seeking to apply a sales tax remittance obligation on the remote seller, rather than a use tax collection obligation, attempting to raise the issue. However, *Wayfair* did not acknowledge those arguments.

¹⁰⁹ 138 S. Ct. at 2088.

The Court understood that the statute at issue imposed on the seller an obligation to remit sales tax — not collect use tax.¹¹⁰

When a consumer purchases goods or services, the consumer's State often imposes a sales tax. This case requires the Court to determine when an out-of-state seller can be required to collect and remit that tax. All concede that taxing the sales in question here is lawful. The question is whether the out-of-state seller can be held responsible for its payment, and this turns on a proper interpretation of the Commerce Clause, U. S. Const., Art. I, [section] 8, cl. 3.¹¹¹

The Court also recognized that both *Bellas Hess* and *Quill* concerned a remote seller's use tax collection obligation, not a sales tax remittance obligation,¹¹² but drew no such distinction in referencing those decisions.¹¹³

Although the Court referred to the seller's requirement to collect and remit the South Dakota sales tax, the South Dakota statute imposes the sales tax directly on the seller, giving the seller the right, but not the obligation, to collect it from the purchaser.¹¹⁴ The Court was indifferent to that distinction.¹¹⁵

Acknowledging agreement of the parties, the *Wayfair* majority opinion interpreted South Dakota's statute as lawfully sourcing the sales tax to the destination, with in-state delivery to the purchaser consummating the sale:

¹¹⁰ 138 S. Ct. at 2089 (“[T]he Act requires out-of-state sellers to collect and remit sales tax ‘as if the seller had a physical presence in the state.’ [section] 1.”).

¹¹¹ 138 S. Ct. 2087.

¹¹² *Id.* at 2091 (“Unless the retailer maintained a physical presence such as ‘retail outlets, solicitors, or property within a State,’ the State lacked the power to require that retailer to collect a local use tax.”); *Id.* (“[*Quill*] presented a challenge to North Dakota’s ‘attempt to require an out-of-state mail-order house that has neither outlets nor sales representatives in the State to collect and pay a use tax on goods purchased for use within the State.’ 504 U.S., at 301”).

¹¹³ *Id.* at 2088 (“Under this Court’s decisions in *Bellas Hess* and *Quill*, South Dakota may not require a business to collect its sales tax if the business lacks a physical presence in the State”).

¹¹⁴ SDCL section 10-64-2.

¹¹⁵ 138 S. Ct. at 2093 (“The central dispute is whether South Dakota may require remote sellers to collect and remit the tax without some additional connection to the State”).

All agree that South Dakota has the authority to tax these transactions. S.B. 106 applies to sales of “tangible personal property, products transferred electronically, or services *for delivery into South Dakota.*” [section] 1 (emphasis added). “It has long been settled” that the sale of goods or services “has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State.” *Oklahoma Tax Comm’n v. Jefferson Lines, Inc.*, 514 U. S. 175, 184 (1995); see also 2 C. Trost & P. Hartman, *Federal Limitations on State and Local Taxation* 2d [section] 11:1, p. 471 (2003) (“Generally speaking, a sale is attributable to its destination”).¹¹⁶

The *Dilworth* formalism would certainly have been relevant to whether South Dakota had the authority to lawfully tax the transactions, if that formalism still had any validity.

The *Wayfair* majority opinion’s interpretation that the tax was lawfully imposed is consistent with the *Berwind-White Coal Mining Co.* majority opinion, which determined — consistent with the state courts — that the transactions subject to New York City’s sales tax were consummated upon delivery of the coal to the purchasers “for consumption.”¹¹⁷ South Dakota’s sales tax law imposed the tax on interstate sales transactions in which the product was delivered to the purchaser for consumption in the state.¹¹⁸

The *Wayfair* majority opinion’s determination that the transaction is consummated upon delivery of property to the purchaser contrasts with the *Dilworth* majority opinion, which — in reliance on the Arkansas Supreme Court’s interpretation — deemed the sales transaction to come to an end upon transfer of the purchased goods to the common carrier in Tennessee, not delivery to the purchaser.

The *Wayfair* majority opinion aligns with the rationales of the *Dilworth* dissents of Douglas and Rutledge. Both justices respected the strong interest of the market state, where the property was delivered to the purchaser, in taxing the transactions at issue. Like Douglas’s dissent in *Dilworth*,¹¹⁹ the *Wayfair* majority opinion drew no distinction for commerce clause purposes between a state imposing on the seller a destination-sourced sales tax and an obligation to collect use tax. In harmony with Rutledge’s emphasis on the importance of the market state having priority over the origin state in imposing a destination-sourced sales tax,¹²⁰ the *Wayfair* majority opinion focused on the benefits that the market state provides to the remote seller:

State taxes fund the police and fire departments that protect the homes containing their customers’ furniture and ensure goods are safely delivered; maintain the public roads and municipal services that allow communication with and access to customers; support the “sound local banking institutions to support credit transactions [and] courts to ensure collection of the purchase price,” *Quill*, 504 U. S., at 328 (opinion of White, J.); and help create the “climate of consumer confidence” that facilitates sales.¹²¹

In referencing the seller’s duty to collect tax from the purchaser as a “sanctioned device,” the *Wayfair* majority opinion quoted both *Berwind-White Coal Mining Co.* (considering a Pennsylvania coal manufacturer’s statutory obligation to collect sales tax on sales of coal to New York City consumers) and *Scripto Inc.* (considering a Georgia seller’s obligation to collect use tax on its sales of merchandise to Florida customers).¹²²

The *Wayfair* majority opinion blurred the distinction between a sales tax and use tax in discussing the flaws in the *Quill* physical presence rule:

¹¹⁶ *Id.* at 2092.

¹¹⁷ 309 U.S. at 59 (“Here the tax is conditioned upon a local activity, delivery of goods within the state upon their purchase for consumption”).

¹¹⁸ SDCL section 10-64-2; Administrative Rule 64:06:01:25.

¹¹⁹ 322 U.S. at 334.

¹²⁰ 322 U.S. at 361.

¹²¹ 138 S. Ct. at 2096.

¹²² *Id.*

Quill's physical presence rule intrudes on States' reasonable choices in enacting their tax systems. And that it allows remote sellers to escape an obligation to remit a lawful state tax is unfair and unjust. It is unfair and unjust to those competitors, both local and out of State, who must remit the tax; to the consumers who pay the tax; and to the States that seek fair enforcement of the sales tax, a tax many States for many years have considered an indispensable source for raising revenue.¹²³

Wayfair's elimination of the *Quill* physical presence standard obviously affects how previous Court decisions concerning the remote seller's obligation to collect sales or use tax should be viewed. The seller's physical presence in the taxing state (such as the presence of agents soliciting sales as in *General Trading* or a sales office in which purchase contracts are executed as in *Berwind-White Coal Mining Co.*) is no longer required to support the remote seller's obligation to collect either sales or use tax, if the seller has economic nexus with the state.

As the *Wayfair* majority opinion stated in criticizing the physical presence rule: "*Quill* imposes the sort of arbitrary, formalistic distinction that the Court's modern Commerce Clause precedents disavow."¹²⁴ The *Dilworth* formalism, indistinguishable from the *Freeman* and *Spector* formalism rejected in *Complete Auto*, likewise falls within that same distinction. Under *Dilworth*, two taxes that the Court has long recognized have the same economic effect — sales tax and use tax — were given different treatment under the commerce clause. The *Dilworth* formalism must be considered overruled by implication.

States with properly drafted sales tax imposition statutes that impose sales tax on interstate transactions and source the sale to the location where the purchaser receives the product, like South Dakota's, should face no constitutionality risk, simply because the remote

seller has a sales tax — not use tax — collection and remittance duty.

Conclusion

Wayfair did not expressly overrule the *Dilworth* formalism, which prohibited states from imposing a sales tax collection duty on remote sellers although recognizing that states could impose a use tax collection duty in similar circumstances. Some argue that this formalism remains part of commerce clause jurisprudence as a trap for the unwary. But *Dilworth* rested on the free trade rule that *Complete Auto* discarded in explicitly overruling *Spector*. *Wayfair* had no need to consider the *Dilworth* formalism; *Complete Auto* had already implicitly overruled it. *Wayfair*'s elimination of *Quill*'s physical presence rule clears the way for a state to impose a sales tax remittance duty on the remote seller meeting the state's economic nexus threshold, assuming the state imposes sales tax on interstate transactions and sources the tax to the delivery destination, as South Dakota does. ■

¹²³*Id.* at 2095-2096.

¹²⁴*Id.* at 2092. Ironically, in *Quill*, the Court rejected the argument that after *Complete Auto*, *Bellas Hess* fell with "*Freeman* and its progeny." 504 U.S. at 310-311. In *Wayfair*, *Quill* and *Bellas Hess* did so fall.

The Sales and Use Tax Dichotomy And the Streamlining Movement

by John A. Swain



Don't tax you, don't tax me, tax that fellow behind the tree.
— Russell Long

Along with failing vision and obsessive-compulsive disorder, familiarity with the use tax and its nuanced distinction from the sales tax helps to separate tax professionals from ordinary mortals.¹ We wince tolerantly or grin smugly when the uninitiated grouse

that a remote Internet retailer might collect “sales tax” on their purchases. The cognoscenti know that a “use tax collection obligation” is the true object of the complaint.²

That can all get a little confusing. The Streamlined Sales Tax Project, for example, produced the Streamlined Sales and Use Tax Agreement (SSUTA, although many call it the SST). The SSUTA, in turn, is overseen by the Streamlined Sales Tax Governing Board. Further, one vainly searches the SSUTA for a definition of sales tax or use tax, while evidently more perplexing terms like “person” and “state” find full explication. To be sure, the model acts that member states (and others) adopted as a prerequisite to governing board membership define sales tax and use tax, but only by cross-referencing the sales and use tax code of the adopting state.³ That hardly provides clarity or ensures uniformity.

¹I would like to thank Walter Hellerstein for his helpful comments on earlier drafts of this column.

²The cognoscenti will also grin (or more likely wince) at my forced use of the phrase “true object,” which has a specialized meaning in the sales and use tax world — the “true object test” is often used to distinguish between nontaxable services or intangibles and taxable tangible personal property.

³Uniform Sales and Use Tax Administration Act section 2; Simplified Sales and Use Tax Administration Act section 2 (reproduced in Walter Hellerstein and John A. Swain, *Streamlined Sales and Use Tax*, app. B & C (2006-2007)).

In fairness, the lack of precision in distinguishing between sales and use taxes usually results in little harm. As a general matter, they are functionally equivalent. The rates are usually the same, although sometimes, either by design or inadvertence, the use tax rate is lower, or a jurisdiction fails to adopt a use tax.⁴ Constitutionally, the use tax base may be equivalent to the sales tax base, but no broader. Otherwise, the tax would discriminate against interstate commerce — that is, out-of-state sellers and in-state purchasers of out-of-state goods. In practice the use tax base is sometimes narrower — for example, when a state fails to extend the use tax to (sales) taxable services.⁵

Why make the distinction between sales and use taxes? Are two taxes really necessary?

Given that functional equivalence, why make the distinction? Are two taxes really necessary? Is there something about the streamlining movement that obviates the sales and use tax dichotomy?

Sales and Use Tax Scenarios

States initially adopted sales taxes to shore up sagging revenue in the midst of the Great Depression. States adopted use taxes, in turn, to shore up gaps in the sales tax attributable to constitutional and practical constraints on taxing transactions consummated outside their borders or in interstate commerce.⁶ Indeed, those taxes are sometimes called “complementary” or “compensating” use taxes. As the sales and use tax matured, it was

⁴As a constitutional matter, use tax rates cannot exceed sales tax rates. Otherwise, purchases from out of state would be taxed at a higher rate than in-state purchases (assuming the in-state purchases would not also be subject to the higher use tax rate), discriminating against interstate commerce.

⁵See generally, 2 Jerome R. Hellerstein and Walter Hellerstein, *State Taxation*, para. 16.01[2] (3rd ed. 2001-2005).

⁶*Id.*

recognized that the use tax had a role to play in other circumstances, such as when an item that was initially purchased for a nontaxable purpose (for example, for resale) was converted by the buyer to a taxable use.

The common sales and use tax fact patterns can be summarized as follows:

Fact pattern 1: Item purchased in state A for use in state A.

Analysis: Seller must collect and remit sales tax. No use tax required.

Fact pattern 2: Item purchased from a state B seller who ships the item to a state A buyer for use in state A. State B seller has a physical presence in state A.

Analysis: Here, one might reasonably expect the state B seller to collect state A sales tax (because it knows the shipping destination). Legal history, however, took a different course. At a time when the U.S. Constitution's Commerce Clause was interpreted "to create an area of [tax] free trade among the several States,"⁷ the U.S. Supreme Court held unconstitutional a state A sales tax imposed on a sale from a state B seller to a state A buyer, while at the same time upholding the imposition of a state A use tax (along with a vendor collection obligation) under essentially identical facts.⁸ The Court reasoned that to tax a "sale" is to tax interstate commerce midstream, while use tax liability arises only after the stream of commerce has disgorged an item onto dry (and purely local) land. As for imposing a use tax collection obligation on the out-of-state seller, the Court said in *General Trading*, "[T]o make the distributor the tax collector of the tax obligation for the State is a familiar and sanctioned device."⁹ If, however, present-day Commerce Clause analysis had been applicable — under which "interstate commerce may be made to pay its own way" — then that "triumph of formalism" would not be necessary, and a properly drafted sales tax statute would bring those interstate sales within the state's constitutional reach.¹⁰ That said, the states (and the courts) have for the most part adhered to that generally harmless formal distinction between the imposition of a sales tax (and the associ-

ated vendor collection obligation) and a use tax (and its associated vendor collection obligation).

Another formalistic relic still plagues this analysis: the physical presence test for seller nexus. In *Quill Corp. v. North Dakota*,¹¹ the Court reaffirmed an earlier decision and held that for state A to impose a sales or use tax collection obligation on a state B seller, the seller must have a physical presence in state A. Noting the large number of state and local taxing jurisdictions and the lack of uniformity in their rules,¹² the *Quill* Court held that although imposing a tax collection obligation on a seller who lacks a physical presence is not fundamentally unfair (it does not violate due process), it does burden interstate commerce.

Applying that decision to fact pattern 2, we conclude that the state B seller will have a state A *use tax collection obligation* because it is *physically present* in the state.

Fact pattern 3: Item purchased from a state B seller who ships the item to a state A buyer for use in state A. The state B seller does not have a physical presence in state A.

Analysis: Following the same analysis presented under fact pattern 2, the state B seller does not have sufficient nexus with state A for state A to impose a tax collection obligation. Accordingly, the state A buyer must remit use tax directly to state A.¹³

Fact pattern 4: Item purchased in state B and transported by buyer to state A for use in state A.

Analysis: The item escapes state A sales tax because the transaction occurred outside state A. Further, the state B seller cannot reasonably be expected to collect state A tax, because, among other reasons, state A has no jurisdiction over the state B seller and the state B seller does not know (and usually cannot be reasonably expected to know) the final destination of the item. Thus, the buyer must remit state A use tax directly to state A, taking a credit (up to the amount of the state A tax) for any state B taxes paid.¹⁴

¹¹504 U.S. 298, 307 112 S.Ct. 1904 (1992).

¹²The doctrine of *stare decisis* played an important, probably decisive, role in that decision.

¹³There is a remote possibility that the state B seller will have collected a state B sales tax. If so, the purchaser would be entitled to a credit for that tax, not to exceed the state A use tax liability. Most (if not all) states, however, would exempt outbound sales that fit within that general fact pattern.

¹⁴In this fact pattern it is more likely than in fact patterns 2 or 3 that a state B sales tax will have been paid because the entire sale, including delivery to the buyer, occurs in state B.

(Footnote continued on next page.)

⁷*McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 64 S. Ct. 1023 (1944).

⁸*Compare McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 64 S.Ct. 1023 (1944) (sales tax) with *General Trading Co. v. State Tax Commission*, 322 U.S. 335, 64 S. Ct. 1028 (1944) (use tax collection).

⁹*Id.* at 338.

¹⁰*Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 281 97 S. Ct. 1076, 1080 (1977).

*Fact pattern 5: Item purchased from state B seller for delivery to state A, but the buyer then transports the item from state A to state C for first use.*¹⁵

Analysis: That is essentially a variant of fact pattern 4, capturing another situation in which the buyer's first use occurs in a state other than the state in which the buyer took delivery of the item. The seller usually collects sales (or use) tax based on the location where the buyer takes possession (the seller has no other information to rely on), but the buyer may have a use tax liability in the state of use. Of course, a credit should be allowed for any sales or use taxes previously paid.¹⁶

Here, however, taxpayers can run into trouble. Assume, for example, that the state B seller does not have nexus with state A, and so it collected no use taxes. Assume further that the purchaser believes that use tax is payable only to state C, the state of its first use, and therefore pays use tax only to state C. State A might still claim that first use occurred in state A and that a state A use tax is due. If the taxpayer has already paid use tax to state C, state A may try to disallow any credit claimed for those state C taxes, asserting that they were unlawfully collected (that is, that there was no first use under state A law or state C law), or, alternatively, that state C should allow a credit against state A taxes, and not vice versa. The roles also could be reversed if tax was initially paid to state A, and now state C asserts that first use occurred in state C and that tax was erroneously paid to state A.¹⁷

Fact pattern 6: Buyer takes delivery of item in state A for use in state A and then uses the item in state C.

Analysis: In that fact pattern, first use occurs in the state of delivery but there is later use elsewhere. Here, sales or use tax will usually already have been paid to state A. Some states, however, impose a use tax even if first use

occurred elsewhere.¹⁸ Therefore, the buyer may have use tax exposure in state C, although a credit (up to the state C tax amount) should be allowed for taxes previously paid.

Fact pattern 7: Buyer in state A obtains a direct pay permit in all states in which it purchases and uses property.

Analysis: Large buyers (generally businesses) often like to take control of their sales tax reporting. Those buyers are in the best position to know where the item will be used and whether it will be used for an exempt purpose. They also are sophisticated enough to assume the sales and use tax reporting function and the associated compliance burdens. Usually state taxing authorities are wary of leaving compliance to buyers who are individual consumers — it is difficult or impossible to enforce the tax against individuals — but ensuring the compliance of business consumers is generally less troublesome. Thus, many states give sellers an option to make direct payment of their sales and use tax. Sellers to whom the buyer gives a direct pay certificate (or registration number) are relieved from any sales or use tax collection obligation.

Fact pattern 8: Buyer in state A purchases an item for a nontaxable use and later uses the item for a taxable purpose.

Analysis: Here the buyer must pay use tax to state A. The typical scenario is when a retailer purchases an item for resale but then converts it to taxable use. For example, a retailer may purchase a television for resale but later withdraw it from inventory and install it in the employee lounge. Because that occurs after the sales transaction, the seller is not in a position to report tax. Thus, it becomes the buyer's obligation.¹⁹

Fact pattern 9: Buyer in state A manufactures an item for its own use.

Analysis: Some states impose a use tax on a buyer's use of self-manufactured items (measured by value), allowing a credit for any taxes paid on the component materials.

Underlying Themes

If we dispense with the sales and use tax nomenclature for a moment, the following themes emerge from the fact patterns discussed above:

¹⁸See 2 Jerome R. Hellerstein and Walter Hellerstein, *State Taxation*, para. 16.03 (3rd ed. 2001-2005).

¹⁹Similarly, a use tax is usually imposed on the buyer when a taxable item was purchased but tax, for whatever reason, was not collected.

When the item is shipped from state B to state A (for example, fact patterns 2 and 3), state B will usually treat the sale as a nontaxable sale for "export."

¹⁵The buyer might also use the product in state B.

¹⁶The seller will not have collected tax if it does not have nexus with state A, the place of delivery.

¹⁷It would seem that one jurisdiction should yield as a constitutional matter, but which jurisdiction? See 2 Jerome R. Hellerstein and Walter Hellerstein, *State Taxation*, para. 18.08[2] (3rd ed. 2001-2005). Cf. *Exxon Corp. v. Wyoming State Board of Equalization*, 783 P.2d 685 (Wyo. 1989) (court affirming over constitutional objection disallowance of credit for earlier paid use tax). In my view, *Exxon Corp.* was erroneously decided, particularly in light of the Supreme Court's subsequent ruling in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 115 S. Ct. 1331 (1995).

- The tax (sales and use tax) can be viewed as a consumption tax measured by the purchase price of the item consumed.²⁰ Not surprisingly, it is generally sourced to the place of consumption.
- The tax is generally more easily enforced against sellers than their disparate buyers, and so the initial tax collection obligation is placed on sellers whenever they are subject to the enforcement jurisdiction of the relevant (see next bulleted entry) taxing authority.²¹
- Sellers generally collect and pay the tax to the jurisdiction in which the place of delivery is located. The place-of-delivery rule both reasonably approximates where consumption will occur and acknowledges the administrative reality that sellers are not in a position to know the buyer's actual place of consumption.
- A purchaser generally must pay the tax when it either (a) acquires an item from a seller that is not subject to the jurisdiction of the taxing authority at the place of delivery;²² (b) makes taxable use of the item in a jurisdiction other than where delivery was made;²³ (c) makes subsequent taxable use of an item for which it claimed an exemption at the time of purchase;²⁴ or (d) has obtained a direct pay permit (thereby, in essence, assuring the state that the purchaser is as reliable as its vendors in remitting tax).
- The risk of noncompliance increases substantially when the tax payment obligation falls solely on the purchaser — particularly an individual purchaser. Thus, taxing authorities can be expected to seek to extend their taxing jurisdiction over sellers as far as possible and to prefer rules that impose a tax collection obligation on sellers at the place of delivery even if actual taxable use may occur elsewhere.
- When the purchaser is a business rather than an individual consumer, however, the compliance concerns of taxing authorities may diminish significantly. Thus, taxing authorities grant direct pay authority to some business purchasers.
- Allowing a purchaser a credit for tax previously paid reduces the risk of double taxation.

The Sales and Use Tax Dichotomy

If sales and use taxes are indeed functionally equivalent, then perhaps the two concepts should be

²⁰The self-manufacturing scenario (fact pattern 9) is an exception to that rule.

²¹As noted above, trustworthy buyers are sometime given authority to directly pay the tax.

²²See fact pattern 3 (without nexus).

²³See fact patterns 4-6.

²⁴See fact pattern 8.

merged.²⁵ That would highlight the truly important distinction in the American retail sales tax: that between the seller's obligation to collect tax and the buyer's obligation to self-report. What follows is an attempt to model the *existing* (that is, this is not a normative model) system using a merged sales and use tax approach.

First, we must give this "rose" a name. Historically, the "sales tax" came first, and that is the name most likely to remain in the common vernacular. However, if we view "use tax" as meaning a tax on consumption, it is the more foundational concept. Accordingly, let's call it the "use tax."²⁶

Second, if the use tax is the foundation of our consumption tax system, we will need to extend it as far as the sales tax to maintain the status quo.²⁷ As noted, the scope of many use tax statutes is narrower than their companion sales tax statutes, particularly as applied to services.

Third, we continue to rely primarily on the seller collection mechanism, with delivery location serving as a workable proxy for consumption.²⁸

Fourth, there will continue to be instances in which the buyer will be required either to initially report the tax in the jurisdiction of delivery (for example, no seller nexus) or to make a reconciling use tax payment elsewhere (for example, when taxable consumption occurs in a jurisdiction other than the jurisdiction of delivery).²⁹

In summary, the current sales and use tax could be characterized as a use tax with two approaches to collection.

A two-stage approach: seller collection and remittance at the delivery location (first stage) with subsequent buyer reconciliation (second stage). That approach applies generally when the seller has

²⁵As previously noted, that would now be constitutionally permissible.

²⁶I am indebted to Walter Hellerstein for the suggestion that use tax might be the more appropriate foundational concept.

²⁷It is not my intent here to propose fundamental tax base reform. Others and I have done that elsewhere. See, for example, Walter Hellerstein and John A. Swain, *Streamlined Sales and Use Tax*, para. 1.01 (2006-07); Charles McLure, "Radical Reform of the State Sales and Use Tax: Achieving Simplicity, Economic Neutrality, and Fairness," 13 *Harv. JL & Tech.* 567 (2000); John A. Swain, "State Sales and Use Tax Jurisdiction: An Economic Nexus Standard for the Twenty-First Century," 38 *Ga. L. Rev.* 343 (2003). That model deviates from the status quo in many states, however, by enlarging the use tax base so that it is identical to the sales tax base.

²⁸Later, I discuss weaknesses in the place of delivery rule in connection with the sourcing of the consumption of services, digital products, and software.

²⁹An additional liability will arise only if the tax rate at the place of consumption is greater than the rate at the place of delivery. Otherwise, the credit for the tax paid at the place of delivery will completely set off any additional liability.

nexus with the delivery location and the buyer has not represented to the seller that the transaction is exempt or that the buyer is a direct payer. Usually, first-stage collection and remittance of the tax by the seller is the end of the matter because consumption occurs (or is deemed to occur) in the same jurisdiction as delivery. If taxable use occurs (or is deemed to occur) elsewhere, however, the buyer is under an obligation to make a reconciling tax payment to the jurisdiction of consumption when the amount of use tax due at the place of consumption exceeds the tax collected by the seller and paid to the jurisdiction of delivery.

It should be recognized that the buyer reconciliation in the two-stage approach is imperfect in that the “wrong” jurisdiction may receive all or most of the tax revenue. That is because the jurisdiction of actual use is constitutionally required to allow a credit for the tax paid to the jurisdiction of delivery. It also operates imperfectly from the purchaser’s perspective when the tax rate at the place of consumption is lower than the tax rate at the place of delivery. In those cases, tax will have been overpaid on the purchase.³⁰ When the tax rate at the place of consumption exceeds the tax rate at the place of delivery, however, the buyer will have paid the “right” amount of tax, although, as noted, some of that tax will have been paid to the “wrong” jurisdiction (the jurisdiction of delivery rather than consumption).³¹

A single-stage approach: buyer self-assessment. That approach generally applies when the seller does not have nexus, the buyer has a direct pay permit, or the buyer claimed at the time of purchase that the product was not taxable, but the product later became taxable through a conversion to taxable use. Here the buyer self-assesses at the place of consumption.³² Note that by avoiding the first-stage payment by the seller at the place of delivery the imperfections of the two-stage approach (potential revenue misallocation and tax overpayment) are avoided. The fundamental weakness of the single-stage approach (as well as the buyer reconciliation stage of the two-stage approach), however, is securing taxpayer compliance.

³⁰Refunds might be available under some facts, and if a uniform system were developed under that model, refund and interjurisdictional adjustment mechanisms could be established to remove those imperfections.

³¹As noted above, refund and interjurisdictional adjustment mechanisms could be established to remove those imperfections.

³²Buyers may still run into fact patterns 4-, 5-, and 6-type reporting quandaries when they take delivery in state A for use in state B. In those situations, state A may claim that tax is due even though the product will be used in another state.

Enter the Streamliners

The advent of electronic commerce brought with it the prospect of a greater proportion of retail sales being made by nonnexus sellers, putting too much stress on the single-stage approach to tax collection (buyer self-reporting), particularly with respect to business-to-consumer transactions.³³ Understandably, therefore, the streamlining movement has focused mainly on expanding seller collection responsibilities (stage one of the two-stage approach).³⁴ However, in the context of the sale of services, digital products, and software, streamliners saw that reliance on seller collection has its downside under the traditional place-of-delivery rules. This is because it is much easier for those items to be consumed in a jurisdiction other than the jurisdiction of delivery. A buyer can more easily transport (or remotely access) \$1 million of software than \$1 million of office furniture. This presents three fundamental problems for the states: tax avoidance, tax base attribution,³⁵ and revenue misallocation.

Tax avoidance can occur when delivery of a high-cost, highly mobile product³⁶ is structured to occur in a low-tax jurisdiction while use is then made of that product in a high-tax jurisdiction (or jurisdictions). Although the buyer typically has a legal obligation to self-assess in the jurisdiction of use, enforcement is difficult as a practical matter, particularly if the buyer is actively seeking to avoid tax. Even when tax avoidance is not intended, collection of tax by the seller at the time of purchase can make a buyer complacent about any further tax reporting obligation.

Moreover, if the product is a service, a digital product, or software that can be used or accessed, for example, by the various branch offices of a business

³³The chances are much greater in a business-to-business transaction that the buyer will comply with the single-stage (self-reporting) approach. It may also be worth observing that the overwhelming proportion of electronic commerce is business to business.

³⁴In their efforts to induce remote sellers to participate, however, streamliners have also encouraged (directly and indirectly) the single-stage approach (buyer self-reporting) by, for example, requiring member states to honor direct pay permits and allowing sellers to accept exemption certificates from buyers without superimposing a “good faith acceptance” requirement. SSUTA section 317 (acceptance of an exemption certificate shifts any tax liability regarding the claimed exempt purchase from the seller to the buyer).

³⁵Although “allocation” has a specialized meaning in the context of state income taxes and, for example, is distinguishable from apportionment in that context, I use the term “allocation” in a broad, nontechnical sense here.

³⁶Motor vehicles, aircraft, and other mobile equipment have been the traditional objects of that genre of tax avoidance transaction, although licensing and registration requirements allow states to more easily compel use tax compliance (self-assessment) for many of these items.

buyer, then the buyer is vexed with the question whether and how to allocate the purchase price to the various points of use. The existing rules regarding the sales and use tax allocation of services, digital products, and software are sketchy at best. Faced with this uncertainty, buyers again may decide to rely on the first-stage collection of tax by sellers and let the audit chips fall where they may, secure in the knowledge that a credit probably will be allowed for any tax already paid to the seller.³⁷

Misallocation will occur even if the two-stage collection process works smoothly.

This leads to the states' concern about the misallocation of revenue among them (and their various local taxing jurisdictions). In fact, and as already noted, misallocation will occur even if the two-stage collection process works smoothly. This is because the jurisdiction of consumption generally must allow a credit for the taxes paid to the jurisdiction of delivery. Further, if the dissonance between the place of delivery and the place of consumption increases as a result of a growing volume of taxable service, digital products, and software transactions, what once might have been considered a minor concession to administrative convenience and federal principles may soon have material revenue allocation consequences.

The history of the streamliners' attempts to resolve those problems is reflected in the various iterations of the now-repealed multiple points of use provision and in a recently adopted interpretation of SSUTA's general sourcing rules as they apply to software- and computer-related services. I will not retrace that history here.³⁸ In general, the approach has been to require or encourage buyers to make a use allocation at the time of the sales transaction, at which time either the buyer or the seller would report tax based on that allocation. One senses the

³⁷As noted in fact pattern 5 above, however, taxing authorities may take a different view, arguing that the previously paid tax was not a lawful tax obligation.

³⁸See generally, Walter Hellerstein and John A. Swain, *Streamlined Sales and Use Tax*, paras. 6.01-.07 (2006-2007).

taxing authorities' instinct that if the allocation is not made at the time of the sale, then it may never be made.

Lurking in the background of this approach is the question whether post-transaction buyer reconciliations should be required if the buyer (or the seller, based on information provided by the buyer) initially made a reasonable allocation based on information available at the time of the transaction. Traditionally, those reconciliations usually are required, but the compliance burden grows significantly when tax on a single purchase already has been allocated (arguably prematurely, and often hurriedly) to multiple jurisdictions. To avoid double taxation, a reconciling buyer usually will be required to pursue cumbersome multijurisdictional refund claims. Thus, it might be wise to treat reasonable allocations as conclusive (for example, treat them as either second-stage buyer reconciliations or as single-stage buyer self-reports) in all but the most unusual or egregious cases.

Finally, an even more nagging question haunts the allocation approach, especially if it involves adoption of ad hoc, buyer-specific, formula apportionment methods:³⁹ Is it worth the candle? At least for a significant subset of transactions, theoretical considerations may need to yield to practicalities. Historically, the difficulties of apportionment "underlie the well-entrenched tradition . . . of generally assigning the retail sales tax base to a single jurisdiction despite the theoretical case that can be made for apportionment when consumption of purchased goods or services occurs in more than one jurisdiction."⁴⁰✧

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³⁹The newly adopted sourcing rule for software and computer-related services illustrates (through various examples) that many multiple points of use transactions can, in fact, be disaggregated into multiple discrete points of delivery to which the traditional place of delivery sourcing rules can be applied. See Eric Parker, "Streamlined Panel Approves Bundling Amendments, Sourcing Rules," *State Tax Notes*, Dec. 18, 2006, p. 789, 2006 STT 240-1, or Doc 2006-24914.

⁴⁰Walter Hellerstein and John A. Swain, *Streamlined Sales and Use Tax*, para. 6.03 (2006-2007).

FROM BEHIND THE TREE

state tax notes®

The Zombie Precedent: *Norton Co. v. Department of Revenue*

by John A. Swain



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In this edition of *From Behind the Tree*, Swain discusses the not quite dead case of *Norton Co. v. Department of Revenue*. The case, which deals with the principle of disassociation, was recently discussed in opinions from courts in Ohio and Washington.

Old cases die hard, particularly those that are not explicitly overruled. One such case is *Norton Co. v. Department of Revenue*.¹ *Norton* is a dead letter, yet, “like some ghoul in a late-night horror movie that repeatedly sits up in its grave and shuffles abroad, after being repeatedly killed and buried, [*Norton*] stalks our [Commerce] Clause jurisprudence once again.”²

In *Norton*, the U.S. Supreme Court addressed the imposition of an Illinois occupation tax “upon persons engaged in the business of selling tangible personal property at retail in this State.”³ The tax was measured by gross receipts. The taxpayer’s receipts included those from sales orders placed by buyers directly with the taxpayer’s out-of-state headquarters and filled by

shipment directly to the buyers. The taxpayer also maintained a Chicago place of business that made retail sales and in some instances facilitated the placement and delivery of home office orders. The Court held that sales either made or facilitated by the Chicago place of business were sufficiently local to be subject to the Illinois tax, but that the direct sales from the home office to Illinois customers were “so clearly interstate in character”⁴ and “dissociated from the local business”⁵ that they enjoyed the then-prevailing immunity from direct taxation of interstate commerce.⁶ The Court distinguished cases involving “sales and use tax[es]” because “the impact of those taxes is on the local buyer or user,” whereas “this tax falls on the vendor.”⁷ In so doing, the Court echoed the view, also prevailing at the time, that imposing a use tax collection obligation on an interstate seller was permissible but that

⁴ *Id.* at 539.

⁵ *Id.* at 537.

⁶ *Id.* at 539. In the same year that *Norton* was decided, “the partial restoration of the ancien régime reached its high-water mark in *Spector Motor Service Inc. v. O’Connor* [340 U.S. 602 (1951)],” in which the Court concluded that states are precluded from taxing the privilege of engaging in interstate commerce. Jerome R. Hellerstein, Walter Hellerstein, and John A. Swain, *State Taxation*, para. 4.10 (2017).

⁷ *Norton*, 340 U.S. at 534. The Court seems to have assumed that the legal incidence of a sales tax necessarily fell on the buyer, which is not always the case. Indeed, the Illinois tax at issue in *Norton* was, in substance, a retail sales tax, whose legal incidence fell on the seller. For the purposes of this analysis, I assume that the Court was making a distinction between taxes whose legal incidence falls on the seller and taxes whose legal incidence falls on the buyer, regardless of nomenclature.

¹ 340 U.S. 534 (1951).

² *Lamb’s Chapel v. Center Moriches Union Free School District*, 508 U.S. 384, 398 (1993) (Scalia, J., concurring).

³ *Norton*, 340 U.S. at 535 (quoting the statute).

imposing a sales tax directly on the seller violated the prohibition against state taxation of interstate commerce.⁸

Norton, however, was rendered obsolete by *Complete Auto Transit Inc. v. Brady*.⁹ In *Complete Auto*, the Court “rejected the line of cases holding that the direct taxation of interstate commerce was impermissible,”¹⁰ as well as the “formal distinction between ‘direct’ and ‘indirect’ taxes on interstate commerce, because that formalism allowed the validity of statutes to hinge on ‘legal terminology,’ ‘draftsmanship and phraseology.’”¹¹ The Court “adopted instead a ‘consistent and rational method of inquiry [that focused on] the practical effect of [the] challenged tax.’”¹²

Unfortunately, at least as a matter of doctrinal clarity, the Court introduced needless uncertainty into the law of state tax jurisdiction by adverting to the formal distinction made in *Norton* between a “direct tax” and “the imposition of a use tax

collection duty” in a case decided just weeks after *Complete Auto*. In *National Geographic*, the taxpayer made substantial mail-order sales of maps, atlases, globes, and books to California residents who responded to its magazine and direct-mail solicitations.¹³ It also maintained two offices in California that solicited advertising for its magazine but conducted no activities related to its mail-order business at those offices. California assessed a use tax against the taxpayer on its mail-order sales. Based on the physical presence of the taxpayer in California, the Supreme Court upheld the assessment against the taxpayer’s nexus challenge. In doing so, the Court rejected the argument that the two California offices should be disregarded for purposes of determining whether the requisite nexus existed because the offices played no role regarding the mail-order sales at issue. The Court wrote:

The Society argues in other words that there must exist a nexus or relationship not only between the seller and the taxing State, but also between the activity of the seller sought to be taxed and the seller’s activity within the State. We disagree. However fatal to a direct tax a “showing that particular transactions are dissociated from the local business,” such dissociation does not bar the imposition of the use tax collection duty.¹⁴

Importantly, however, *National Geographic* did not actually answer the question it impliedly raised regarding disassociation and direct taxes, because it was sufficient for the Court to reject the taxpayer’s disassociation argument by concluding that a use tax collection obligation was distinguishable from a direct tax.

In any event, any lingering notion that a direct tax obligation enjoys greater dormant commerce clause protection than an indirect use tax collection obligation was turned on its head by the Court’s decision in *Quill*.¹⁵ Relying in part on the doctrine of *stare decisis*, but also on an examination

⁸ At a time when the commerce clause was interpreted “to create an area of [tax] free trade among the several States,” *McLeod v. JE Dilworth Co.*, 322 U.S. 327 (1944), the Court held that an Arkansas tax imposed on sales by a Tennessee seller to Arkansas buyers violated the commerce clause while an Iowa tax on the use of goods sold by a Minnesota seller to Iowa buyers was constitutional, as was the associated vendor collection obligation. *McLeod*, 322 U.S. at 327 (holding sales tax on interstate sales unconstitutional); and *General Trading Co. v. State Tax Commission*, 322 U.S. 335 (1944) (holding use tax and associated use tax collection obligation imposed on out-of-state seller constitutional). The Court reasoned that taxing a cross-border sale is taxing interstate commerce, which lay beyond the state’s taxing power, whereas a use tax was imposed on a local event over which the state had well-recognized authority. As for imposing a use tax collection obligation on the out-of-state seller, the Court said in *General Trading* that “to make the distributor the tax collector of the tax obligation for the State is a familiar and sanctioned device.” *General Trading*, 322 U.S. at 338. If contemporary commerce clause analysis had been applicable when states were adopting sales and use taxes, this “triumph of formalism” would not have been necessary, and a properly drawn sales tax statute (which would require, among other things, a credit for any taxes paid to the state in which the sale originates) would have brought most interstate sales within the states’ constitutional reach. *Complete Auto Transit v. Brady*, 430 U.S. 274, 281 (1977). See Hellerstein, Hellerstein, and Swain, *supra* note 6, at paras. 4.07-4.12 (2017) for a discussion of the historical development of state tax dormant commerce clause doctrine. That said, most states continue to adhere to the dichotomy established in *McLeod* and *General Trading* and impose sales tax on intrastate sellers while imposing use tax (and an associated vendor collection obligation) on purchases from out-of-state sellers. See generally John A. Swain, “The Sales and Use Tax Dichotomy and the Streamlining Movement,” *State Tax Notes*, Jan. 15, 2007, p. 129.

⁹ *Complete Auto*, 430 U.S. 274.

¹⁰ *Quill Corp. v. North Dakota*, 504 U.S. 298, 303 (1992).

¹¹ *Id.* at 310 (quoting *Complete Auto*, 430 U.S. at 281).

¹² *Id.* at 304 (quoting *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980) (emphasis supplied)).

¹³ *National Geographic Society v. State Board of Equalization*, 430 U.S. 551 (1977).

¹⁴ *Id.* at 560 quoting *Norton*, 340 U.S. at 537 (citations omitted).

¹⁵ *Quill*, 504 U.S. at 298.

of the “practical effect of [the] challenged tax,”¹⁶ which included the burdens (common to *both* sales and use taxes) of complying with “many variations in rates, in allowable exemptions, and in administrative and record-keeping requirements,”¹⁷ the Court preserved a physical presence nexus standard for use tax collection obligations, while at the same time implying that physical presence may not be required for “other types of taxes,” *many of which are direct taxes*.¹⁸ Indeed, judicial and administrative decisions across the country have overwhelmingly supported the view that *Quill*’s physical presence test does not extend to direct taxes such as income and gross receipts taxes.¹⁹ These authorities have held that physical presence — whether dissociated or not from the subject matter of these taxes — is not required to establish nexus under the commerce clause.

In case there were any remaining doubt on this point, the Court recently reconfirmed the irrelevance of the distinction between direct and indirect taxes for dormant commerce clause purposes in *Comptroller of the Treasury v. Wynne*.²⁰ In *Wynne*, the Court relied heavily on three gross receipts tax cases²¹ in concluding that portions of Maryland’s personal net income tax regime violated the commerce clause.²² In response to Justice Ruth Bader Ginsburg’s claim in dissent that the Court had traditionally distinguished between gross receipts and net income taxes, the Court rejected the claim as inconsistent with its contemporary approach to state taxation under the commerce clause, writing “we see no reason why the distinction between gross receipts and net income should matter, particularly in light of the admonition that we must consider ‘not the

formal language of the tax statute but rather its practical effect.”²³ In the Court’s view, “the discarded distinction between taxes on gross receipts and net income was based on the notion, endorsed in some early cases, that a tax on gross receipts is an impermissible ‘direct’ and ‘immediate’ burden on interstate commerce, whereas a tax on net income is merely an ‘indirect and incidental’ burden.”²⁴

Most Recent Burial

In *Crutchfield v. Testa*,²⁵ the Ohio Supreme Court read what should have been *Norton*’s last rites. In deciding that the *Quill* physical presence test does not apply to the Ohio commercial activity tax, the court observed that “the main flaw in *Crutchfield*’s argument lies in its reliance on case law that embodies the since-discarded theory of interstate-commerce immunity from state taxation.”²⁶ The Ohio court considered *Norton* at length, noting first that the Supreme Court remanded the case to the Illinois courts for the purpose of determining which transactions involved purely mail-order business. Those transactions would be immune from tax. The court then quoted this passage from *Norton*, describing it as the “linchpin of the Court’s analysis”:

“Where a corporation chooses to stay at home in all respects except to send abroad advertising or drummers to solicit orders which are sent directly to the home office for acceptance, filling, and delivery back to the buyer, it is obvious that the State of the buyer has no local grip on the seller. *Unless some local incident occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable. Of course, a state imposing a sales or use tax can more easily meet this burden, because the impact of*

¹⁶ *Id.* at 304 (quoting *Mobil Oil Corp.*, 445 U.S. at 443).

¹⁷ *Quill*, 504 U.S. at 313 n.6 (quoting *National Bellas Hess Inc. v. Department of Revenue*, 386 U.S. 753, 759-760 (1967)).

¹⁸ *Quill*, 504 U.S. at 314.

¹⁹ See Hellerstein, Hellerstein, and Swain, *supra* note 6, at paras. 6.03[2], 6.11.

²⁰ *Comptroller of the Treasury v. Wynne*, 575 U.S. ___ (2015).

²¹ *JD Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938); *Gwin, White & Prince Inc. v. Henneford*, 305 U.S. 434 (1939); and *Central Greyhound Lines Inc. v. Mealey*, 334 U.S. 653 (1948).

²² For a detailed analysis of *Wynne*, see Hellerstein, Hellerstein, and Swain, *supra* note 6, at para. 4.16[1][a][vii]. See also Walter Hellerstein, “Deciphering the Supreme Court’s Opinion in *Wynne*,” 123 *J. Tax’n* 4 (2015).

²³ *Wynne*, 575 U.S. ___ (citation omitted).

²⁴ *Id.* (citation omitted).

²⁵ No. 2015-0386 (Ohio 2016).

²⁶ *Id.*

those taxes is on the local buyer or user. Cases involving them are not controlling here, for this tax falls on the vendor.”²⁷

The Ohio court observed further:

At first blush, this passage could be mistaken for a statement about the substantiality of nexus, and that is precisely the error that Crutchfield makes. Read in context, however, the passage does not at all comment on “substantial nexus”; instead, it reflects the interstate-commerce-immunity theory, whereby the sales made by or through local agents in the state — such as the purchases in Ohio of Crutchfield’s products — are taxable as local commerce, but the strictly mail-order transactions are immune as purely interstate commerce.

Crutchfield maintains that the local incident in a case like *Norton* equates to the substantial nexus requirement of the *Complete Auto* test. That is wrong. *Complete Auto* abolished the prohibition against levying a tax on the privilege of engaging in interstate commerce and the Supreme Court’s articulation of the substantial nexus test was not intended to resurrect it.²⁸

Ensuing Exhumation

In a case decided just six days later, however, the Washington Supreme Court ignored *Crutchfield*’s admonition (perhaps under the influence of a voodoo spell) and disinterred *Norton*’s deconstructed remains.²⁹ Avnet Inc. was a distributor of electronic components, computer products, and embedded technology. During the audit period, Avnet had gross receipts of more than \$200 million from the sale of goods shipped into Washington from an out-of-state warehouse. Approximately \$80 million of those receipts came from national and drop-shipment sales — the orders for which were placed with Avnet sales offices outside Washington and fulfilled by

shipment directly to the in-state location of the customer (or the customer’s customer). Avnet maintained a Washington office with more than 40 employees, including account managers, sales and marketing representatives, engineers, and technology consultants.³⁰

Avnet challenged the assessment of business and occupation (B&O) tax on its national and drop-shipment sales, arguing that the dormant commerce clause barred the imposition of B&O tax because, under the authority of *Norton*, these sales were dissociated from Avnet’s in-state activities and thus did not have a substantial nexus with the state.³¹ The taxing authority contended that *Norton* had been effectively overruled, but the court treated *Norton* as “good law,”³² at least as it “pertains to the principle that the taxpayer has the burden to show that the bundle of its in-state corporate activities are ‘dissociated from the local business and interstate in nature.’”³³

In the court’s view, Supreme Court decisions after *Norton* merely gave additional guidance on “how a company must show dissociation.”³⁴ The court particularly relied on *Tyler Pipe*, which held that “the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this state for sales.”³⁵ Applying that test to Avnet’s in-state activities, the court found that Avnet’s substantial in-state presence was associated with establishing and maintaining a market for its national and drop-

²⁷ *Id.* (quoting *Norton* at 537).

²⁸ *Id.*

²⁹ *Avnet Inc. v. State Department of Revenue*, 384 p.3d 571 (Wash. 2016).

³⁰ *Id.* at 573-574.

³¹ *Id.* at 576-577.

³² *Id.* at 580.

³³ *Id.* As discussed above, the notion that transactions that are “interstate in nature” enjoy immunity from state taxation has long ago been abandoned, and it is unfortunate that the court persists in giving credence to this obsolete doctrine. See generally Hellerstein, Hellerstein, and Swain, *supra* note 6, at para. 19.02[3][b].

³⁴ *Id.*

³⁵ *Id.* (quoting *Tyler Pipe Industries Inc. v. Washington State Department of Revenue*, 483 U.S. 232, 250 (1987) (quoting *Tyler Pipe Industries Inc. v. Department of Revenue*, 715 P.2d 123 (Wash. 1986)).

shipment sales. Thus, the dormant commerce clause did not bar the imposition of B&O tax on those sales.³⁶

Although the Washington Supreme Court's ultimate conclusion was correct, it was unnecessary for the court to consider whether Avnet's undisputedly substantial physical presence in the state was associated with its sales to Washington customers. First, several state courts have held that the *Quill* physical presence test does not extend to gross receipts taxes.³⁷ If those courts are correct, then an in-state physical presence (associated or not) would not be required as a constitutional matter for B&O tax to apply to all of Avnet's Washington sales. Second, and more importantly, the U.S. Supreme Court's observation in *Tyler Pipe* that the "crucial factor governing nexus is whether the activities performed *on behalf of* the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state"³⁸ is best read as a limitation on the attribution of the in-state presence of *independent contractors* to a taxpayer, and not, as the *Avnet* court would read it, as a limitation on the significance of the taxpayer's actual physical presence in the state as evidenced by the presence of the taxpayer's *own employees and offices*.³⁹

Conclusion

And so *Norton* walks again, "frightening the little children"⁴⁰ and taxing authorities of Washington state, and annoying legal academics with a penchant for doctrinal tidiness. ■

³⁶ *Id.*

³⁷ See Hellerstein, Hellerstein, and Swain, *supra* note 6, at paras. 6.03[2], 6.11.

³⁸ *Tyler Pipe*, 483 U.S. at 232 (quoting *Tyler Pipe Industries Inc.*, 715 P.2d at 126 (emphasis added)).

³⁹ See Hellerstein, Hellerstein, and Swain, *supra* note 6, at para. 19.02[2][a] (discussing *Tyler Pipe* and independent contractors).

⁴⁰ *Lamb's Chapel*, 508 U.S. at 398 (Scalia, J., concurring).

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