

LEGAL SERVICES

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MEMORANDUM

February 11, 2017

SUBJECT: Tax on Sales Occurring Outside of the State
(Work Order No. 30-LS0151J)

TO: Senator Cathy Giessel
Attn: Kari Nore

FROM: Emily Nauman 
Legislative Counsel

Please find the abovementioned bill attached. You requested that the bill require an online retailer to collect the studded tire fee and remit it to the state. As I discussed with Ms. Nore, under current law, based on the federal commerce clause, a state can not compel an out of state vendor whose only contacts with the state are by mail or common carrier to collect a state tax. There are several possible resolutions. Some background is needed. Therefore, this memo briefly reviews the history of the constitutional issue. A discussion of possible solutions follows.

I. A BRIEF HISTORY: TAX COLLECTION BY AN OUT-OF-STATE ENTITY

In 1992, in *Quill Corp. v. North Dakota*, the United States Supreme Court held that, under the federal commerce clause, a state cannot require a retailer to collect a tax on behalf of a state in which it has no physical presence because to do so would place an undue burden on interstate commerce.¹ The *Quill* decision reaffirmed the commerce clause test of *Complete Auto Transit v. Brady*, finding that mail order solicitation by a company unaccompanied by the company's physical presence in the taxing state was not sufficient to meet the "substantial nexus" standard under commerce clause analysis that would justify the obligation to collect and remit the use tax on purchases of cigarettes.²

In 2010, Colorado enacted a law mandating that remote sellers inform each customer of her or his annual purchases and remit the same information to the state of Colorado. In August of 2013, in the United States Supreme Court ruled on a procedural issue related to the Colorado law. Importantly, in his concurring opinion, Justice Kennedy pressed the legal system to "find an appropriate case for [the] Court to reexamine *Quill*."³

¹ 504 U.S. 298, 312.

² 430 U.S. 274, 51 L.Ed.2d 326, 97 S.Ct. 1076 (1977).

³ *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124, 1135 (2015).

Following the remand to the lower court, the Tenth Circuit ruled that Colorado's reporting requirement was constitutional because it placed no additional burden on interstate commerce. The Tenth Circuit noted that the law did not require sellers to comply with a greater burden of tax collection and reporting, and the statute did not require out-of-state retailers to assess, levy, or collect a tax on the state's behalf.⁴ This ruling was also appealed to the United States Supreme Court and, recently, on December 12, 2016, certiorari was denied.

In summary, it appears the United States Supreme Court has been primed, and is looking for an appropriate case to overturn or modify the *Quill* holding. However, at this time, *Quill* is still law; a state can not compel an out of state vendor whose only contacts with the state are by mail to collect a state tax.⁵

II. OTHER STATES, POSSIBLE SOLUTIONS.

A. Amazon Laws. Recently several states have recently employed an "economic nexus" model in state sales and use tax laws.⁶ In other words, states are adopting laws attempting to meet the *Quill* and *Complete Auto* test of a "substantial nexus" to the state by establishing that nexus through economic activity in the state. These laws have been nicknamed "Amazon laws," presumably after amazon.com.

Given that more than a few states have adopted an economic nexus model, and the comments of Justice Kennedy, it seems only a matter of time until the United States Supreme Court takes up a case reviewing the *Quill* decision. At this time, it is not clear which state law will be the foundation of this case.

⁴ *Direct Mktg. Ass'n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016), cert. denied, (U.S. Dec. 12, 2016).

⁵ Ms. Nore mentioned she thought that a "fee" might be viewed differently by the Court. I disagree. The Court cited the burden on interstate commerce as the collection of the tax, a fee puts the same burden on a seller.

⁶ Under the "economic nexus" model, a company is deemed to have nexus with the taxing state if the company has sales in the state; there is no physical presence requirement. Ohio, South Dakota, Alabama, and Washington have passed measures adopting various forms of economic nexus. In South Dakota, sellers with annual sales over \$100,000 or with 200 separate transactions in the state are deemed to have nexus with the state and are obligated to collect and remit tax. In Alabama, sellers with over \$250,000 of annual sales are deemed to have nexus in the state even though they don't have any physical connection with the state. Idaho, Illinois, Louisiana, Mississippi, Nebraska, Oklahoma, Utah, Rhode Island, and Vermont have all introduced legislation which would create a similar economic nexus test.

Coming back to the bill, it is advisable for your legislation to incorporate an economic nexus model. While it is unclear if the economic nexus model is constitutional, it certainly is a step towards attempting to establish a "substantial nexus" with the state.

Even if an economic nexus model is used in your bill, note that there has been no United States Supreme Court case overturning *Quill*. Nor has there been congressional action that negates *Quill* as the benchmark for determining when a company has nexus in a state for sales tax purposes. *Quill* is still the law, thus, if the bill does enact an economic nexus model, it could be open to constitutional attack. On the other hand, if the bill adopts an economic nexus model it would be prepared in the event that *Quill* is overturned and could potentially increase revenue, not forgo income lost in the meantime.⁷

B. Collection from Users. A second option in your bill is to require a person using studded tires in the state that were purchased outside the state to pay a user fee. Because the person being taxed is in the state, commerce clause issues do not arise. In addition, you could require an online seller to notify the state and the purchaser of the studded tire purchase, similar to the law enacted in Colorado.⁸

One point of clarification. Ms. Nore called me several days ago and asked if the bill imposed a fee on the installation of studded tires. I provided the accurate answer, it does not. However, the bill does impose a fee for the installation of studs onto a tire.

If I may be of further assistance, please advise.

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⁷ It might also be possible to to enact an economic nexus requirement that springs into effect if *Quill* is overturned.

⁸ Again, the Tenth Circuit found that the Colorado law did not violate the commerce clause. The ruling was appealed to the United States Supreme Court and certiorari was denied.