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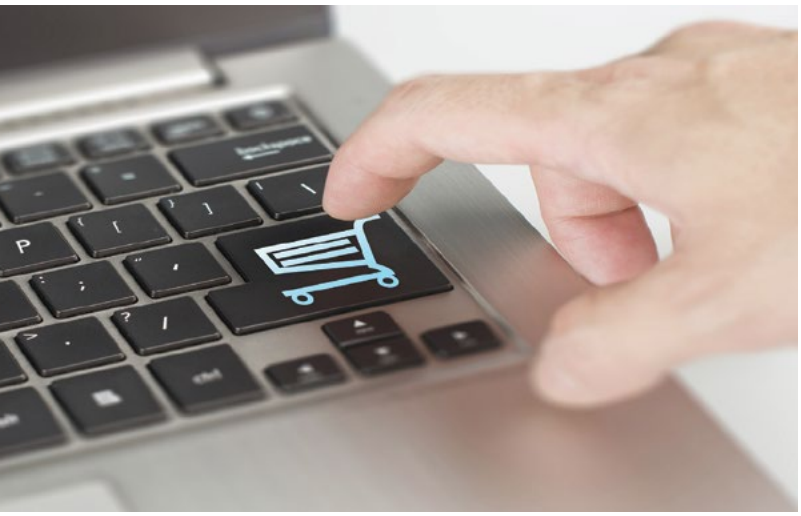
25 YEARS AGO >>

# Taxes on Internet sales and use

BY DAVE COTTON, CPA



It is easy to take for granted the way the profession is today — and assume it's always been that way. Ours is an evolving and dynamic profession. This column looks at the way we were a quarter-century ago.

## It *sounds* like a relatively recent

controversy: Can states assess sales taxes on a company that sells products to the state's residents even though the company has no physical presence in the state? After all, 25 years ago, Al Gore was just starting to invent the Internet.

In the June 1992 issue of *Disclosures*, Paula Anthony's award-winning[1] article, "Sales and use tax issues on a national and local level," appeared. The then-controversy related primarily to *mail order* sales. States were discovering that they were losing billions in tax revenues due to mail orders. Paula's article began, "Departments of revenue all over the country are anxiously awaiting a United States Supreme Court ruling on the *Quill v. North Dakota* case."

North Dakota had recently amended its sales tax laws to mandate collection of sales taxes from mail order companies doing business with state residents or companies. Twenty-seven other states got on board that revenue-collection train as well. Quill (an office supply company) sued North Dakota and the North Dakota Supreme Court ruled in the state's favor — i.e., that the state could collect taxes from Quill. Paula's article provided an excellent description of how the issue affected states' revenues, but also explained the complex implications for accountants and auditors who had to deal with the ramifications of these tax collection efforts and compliance issues. (If you are interested in seeing her article, email me and I will send it to you.)

So, how was the controversy resolved? Well, it hasn't been. The Supreme Court of the United States (SCOTUS) overturned *Quill v. North Dakota* on May 26, 1992 (shortly after Paula's article went to print). SCOTUS said, "The State's enforcement of the use tax against Quill places an unconstitutional burden on interstate commerce."[2] But, SCOTUS also said, "The underlying issue here is one that Congress may be better qualified to resolve, and one that it has the ultimate power to resolve,"[3] thereby inviting the legislative branch to join the fray.

Currently, most states have enacted "use taxes." Residents of a state are obligated to pay a "use" tax if the seller does not collect and pay a "sales" tax; and the rates are usually the same for both the "sales" and the "use" tax. That would satisfy a state's appetite for collecting taxes, except for the fact that it's easier to collect taxes from the smaller number of sellers than from individual buyers.

So, where do we stand on this? The overarching principle is still related to "physical presence." If a seller has a "physical presence" (store, office, warehouse, plant or sales representative) in a state, then the seller must pay the state its sales tax. But, it's not that simple. The word "nexus" appears 54 times in SCOTUS's Quill decision. States adroitly determined that "physical presence" and "nexus" are not necessarily the same thing. "[M]any states, including Virginia, have used the term "nexus" rather than "physical presence" in their sales tax laws, and, in the process, have sometimes defined nexus in ways that some people may think goes beyond physical presence."[4] According to the Virginia Department of Taxation FAQ page [VADOTFAQ], "An out-of-state seller must register with the Department and collect the tax on sales to Virginia customers if the seller has sufficient nexus, or contact, with Virginia. If the seller does not have nexus with Virginia, there is no requirement to collect the tax or register for a use tax account. For further information on nexus criteria, see Virginia Code Section 58.1-612." Virginia Code Section 58.1-612 contains 2,435 words. Problematically, however, "nexus' is not one of them. The 2,435 words attempt to explain when a "dealer" must register to collect and pay taxes.

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Many states (Maryland and District of Columbia, but not yet Virginia) have embraced a concept called "click-through-nexus." Here's how it works: Business A has no physical presence in a state, but an unrelated Business B in the state has a website. Business B's website has a link to Business A or one of its products. Bingo — via click-through-nexus, Business A must remit taxes to the state.

Several members of U.S. Congress recently accepted SCOTUS's 1992 invitation to bring closure (if not clarity) to this issue via federal legislation. The "Marketplace Fairness Act" is percolating in the House and was passed by the U.S. Senate in May 2013. In a nutshell, the Act would "require all sellers not qualifying for the small-seller exception (applicable to remote sellers with annual gross receipts in total U.S. remote sales not exceeding $1 million in the preceding calendar year) to collect and remit sales and use taxes for remote sales …"[5]

The Internet Tax Freedom Act was enacted in 1998 but expires on Nov. 1, 2014. It prevents state and local governments from taxing electronic commerce. (Consider paying the state, say, $.10 per email or per website visited and the federal government $.15 per email or per web site visited.) If nothing happens before the expiration date, the tax floodgates will open wide. Virginia Rep. Bob Goodlatte recently sponsored the "Permanent Internet Tax Freedom Act." His 98-word bill would "permanently extend the Internet Tax Freedom Act." It passed the House on July 15, 2014, by voice vote. Stay tuned.

Paula Anthony concluded her excellent 1992 article by summarizing:

> "When the United States Supreme Court rules on the *Quill v. North Dakota* case, either the states will realize a windfall in sales taxes collected by all mail order companies and use taxes will no longer be such an issue or states will be forced to continue their efforts at collecting taxes, knowing that a lot of revenue will still be slipping through the cracks. Either way, auditors will have to evaluate controls on compliance with sales and use tax laws when performing an audit."

Paula likely never imagined that 22 years after her article was published, the issue remains incompletely resolved and, with the explosion of Internet commerce, more important and contentious than ever. ■

*Author's note: Special thanks to Art Auerbach, CPA, for his valuable input to and experienced insight on this article.*


1. Paula Anthony was a student at Old Dominion University in 1992 and her article won the 1991–1992 *Disclosures* Student Manuscript Contest.
2. See http://caselaw.lp.findlaw.com/scripts/get-case.pl?court=US&vol=504&invol=298
3. Ibid.
4. See www.nolo.com/legal-encyclopedia/virginia-internet-sales-tax.html
5. See https://beta.congress.gov/bill/113th-congress/senate-bill/743

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