

Brick and Mortar Fights Back: $23 Billion at Stake for State and Local Governments

by Erich R. Eiselt, Assistant General Counsel

On May 6, 2013, The Marketplace Fairness Act of 2013[1] (MFA) passed the United States Senate by a lopsided margin of 69 to 27. If enacted, the MFA (commonly referred to as the "Internet Sales Tax Act") will allow states to require that out-of-state vendors collect and remit sales taxes even though they have no physical presence in the taxing state.

The potential benefits to states and municipalities are immense. The legislation will unlock an estimated $23 billion a year in uncollected sales taxes, according to the National Conference of State Legislatures.[2]

In so doing, the MFA would overturn a status quo that has long frustrated state taxing authorities. For nearly 50 years, the Supreme Court has firmly barred states from extracting sales or use taxes from out-of-state vendors without a substantial nexus to the taxing state. Two decisions form the barrier:

In *National Bellas Hess v. Department of Revenue of Ill.*, 386 U.S. 753 (1967), a Missouri mail order house had been directed to collect Illinois use taxes. The State's tax law required collection by entities 'Engaging in soliciting orders within this State from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this State.'[3] Bellas Hess owned no tangible property in Illinois, and had no retail outlets or sales representatives there. It did not advertise in Illinois on radio, television, billboards, or newspapers. But it did send occasional catalogues to Illinois customers and shipped goods to them.

The Court rebuffed the State of Illinois. It held that Bellas Hess' contacts with the State were too tenuous to sustain jurisdiction under the Due Process Clause. And it found that the State sustained too little burden from Bellas Hess' activities to justify interfering in interstate commerce under the Dormant Commerce Clause. Illinois could not impose a duty of use tax collection on an out-of-state seller whose only connection with customers was by common carrier or by mail.

Twenty-five years later, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) presented a similar question. Quill, a seller of office supplies and equipment, had no offices or warehouses in North Dakota, and no retail locations, no employees, or sales representatives there. Yet, by mailing more than 230,000 catalogs and flyers--some 24 million tons of advertising--into the State each year, Quill sold roughly $1,000,000 of goods to 3,000 North Dakota customers. And it facilitated their purchases by providing floppy disks containing order entry software. North Dakota law required payment of sales taxes by "retailers," who were defined as "every person who engages in regular or systematic solicitation of a consumer market" in the State.[4]

The North Dakota Supreme Court had held for the State. Citing the meteoric growth of mail order sales since 1967, it referred to "tremendous social, economic, commercial and legal innovations" that had made *Bellas Hess* obsolete.[5] It discerned a softening of the traditional "minimal contacts" needed to satisfy Due Process. And it saw a relaxation of the requirement that an out-of-state business must have a "physical presence" in the taxing state in order to avoid friction with the Dormant Commerce Clause.

The Supreme Court agreed with North Dakota's Due Process analysis: Quill's intentional contacts with the State satisfied the fundamental fairness and notice elements essential to Due Process. But the Court emphatically reaffirmed the continuing vitality of *Bellas Hess* and its teaching that the Commerce Clause prohibits taxation of out-of-state entities with no physical presence in the taxing state.

The solution, Justice Stevens wrote for a unanimous Court, lay with Congress: "Accordingly, Congress is now free to decide whether, when, and to what extent the States may burden interstate mail order concerns with the duty to collect use taxes."[6]

The twenty years since *Quill* have witnessed a global proliferation of cyber-based sales and marketing virtually unimaginable to the Court. As of 2009, internet-based sales were $145 billion, roughly four percent of the nation's $3.6 trillion in total retail sales.[7] By 2012, e-commerce sales had grown to $226 billion, or 5.2 percent of the total.[8] This year, the figure will top $250 billion.[9]

The unfairness which the states were challenging in *Bellas Hess* and *Quill* is greatly magnified in the e-commerce context. A brick and mortar business spends many thousands of dollars to rent, outfit and maintain a store. It pays salaries, utility bills and premises insurance. It can operate only during "business hours." It keeps inventory on hand to satisfy buyers who demand on the spot purchasing. And it must collect and remit state and local sales taxes, sometimes nearing 10 percent of the purchase price.

The "virtual" business spends nothing in the taxing jurisdiction. It has no store. It relies on a robust website and a network of connections to manufacturers, distributors and shippers. It does not need to ship catalogues or flyers. It pays no utilities, rent or salaries in the taxing jurisdiction—but stays open 24 hours a day, often through the use of off-shore call centers. And it sells in the taxing jurisdiction free of any sales tax obligations. Internet buyers may go to brick-and-mortar establishments in local malls and town centers to see and touch goods—and then purchase them on-line.

Although they are legally obligated to pay a use tax on those transactions, the vast majority of consumers are unaware that such laws exist. Even when they do know, compliance is minimal.

State and local governments are particularly victimized. They are deprived of vital tax revenues that would fund education, health, safety and infrastructure, even as their in-state businesses fall prey to unseen commercial internet predators. Storefronts on Main Street are shuttered and local unemployment climbs.

States have moved to redress the problem while trying to live within *Bellas Hess* and *Quill*. One approach has been to establish so-called "Amazon laws." Originated by New York in 2008[10] and now adopted by a half-dozen states including Texas, California and Pennsylvania, these statutes assert taxability where an out-of-state vendor (often Amazon, as the name implies) uses in-state on-line "associates" to generate sales. For example, a Virginia-based discount camera seller might place an advertisement in the *Los Angeles Times* website, providing the paper with commissions where Times readers "click through" to the camera seller's website and make a purchase. California's Amazon law would tax such transactions. Enacted in 2011, it defines a "retailer engaged in business in the State" as including "any retailer entering into agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers, whether by an Internet-based link or an Internet Web site, or otherwise, to the retailer. . . "[11]

The "Amazon laws" are not free from litigation or Constitutional challenge. It is true that the New York Court of Appeals recently upheld that State's Amazon law, finding that, where an out-of-state entity pays an in-state website owner for referring sales, enough nexus exists to satisfy Commerce Clause concerns.[12] But that case, and the "click through nexus" rationale in general, has not yet been tested at the Supreme Court. And some large on-line sellers, including Amazon.com and Overstock.com, have simply curtailed their in-state associate arrangements so as to circumvent the taxation statutes.[13] A more sweeping answer is needed.

As Justice Stevens advised, the solution would appear to lie with Congress. The MFA may be that solution. It is a bipartisan offering, intended to redress unfairness and overrule the Supreme Court. Republican Senators Mike Enzi (R-Wyoming) and Lamar Alexander (R-Tennessee) joined Democrat Dick Durban (D-Illinois) to introduce legislation in 2011 that would clearly allow states to collect sales taxes on internet sales.[14] MFA's intent should cheer Democrats and Republicans alike: it is styled as "An Act to restore States' sovereign rights to enforce State and local sales and use tax laws, and for other purposes."[15]

The MFA as passed by the Senate in early May is straightforward and perhaps deceptively simple, at only five pages (fewer than 2,000 words) in length. Its primary accomplishment is to deal with what has been a major obstacle to passage--the complex thicket of state and local sales tax regulations that would drown all but the largest of vendors in bureaucracy and paperwork. Indeed, both *Bellas Haas* and *Quill* had referenced the compliance burden as part of the Court's rationale, referring to a "welter of complicated obligations" that would confront sellers.[16]

That complexity has been greatly reduced, as a website established by proponents of the MFA asserts.[17] States cannot simply "opt in" under the MFA to begin reaping taxes; they must affirmatively simplify their sales tax structure. They must also designate a single, centralized state tax organization and provide retailers with free tax calculation software.

States can comply on an a la carte basis, or by passing legislation which conforms to the Streamlined Sales and Use Tax Agreement (SSUTA)[18], as twenty-four states have already done.[19] Although the SSUTA is a daunting 204-page document, it does inject uniformity into as many as 6,000 or more disparate taxing structures around the US.

The MFA has also been designed, say its advocates, to spare small business. It applies only to entities that generate more than $1 million in annual revenues from out-of-state sales.

The overwhelming Senate win was heartening for MFA proponents, including municipalities that stand to gain tax revenues. Large brick and mortar retailers including Wal-Mart and Home Depot support the law, for obvious reasons. Even Amazon has come on board as it builds more warehouses and infrastructure around the country to assure ever more rapid product shipments.

But it is far too early to predict a win for the states. Prospects for passage of the MFA in the House, where the "fairness" argument meets strong crosswinds, are hardly rosy. Many Republicans challenge the assertion that streamlined compliance obligations solve the problem for small business. As the main corporate antagonist to the MFA, eBay, points out, the "small business" threshold may need to be increased: at an average profit margin on internet sales of 8.3 percent, businesses making just $83,000 per year in profits will now have to spend time and money paying sales taxes across the country. It has strenuously sought to push the MFA minimum to $10 million for out-of-state revenues. (While not directly on point, it is worthwhile noting that the Small Business Administration defines a "small business" at a $7 million revenue threshold, in some categories going up to $30 million).

And many conservatives, including Grover Norquist, view the taxes as "new" despite a longstanding duty in most States for consumers to pay use taxes on purchases where sales taxes are not collected. Some critics go even farther, characterizing the MFA as yet another step in a liberal agenda to maximize the shifting of private dollars to public coffers.[20]

Behind the rhetoric, billions in tax revenues hang in the balance. Municipalities should keep tuned to the Marketplace Fairness Act of 2013 as the summer progresses.

Notes

1. S.743 113rd Cong. (2013); text at http://thomas.loc.gov/cgi-bin/query/D?c113:2:./temp/~c113dUmWNe: (last accessed May 13, 2013.
2. http://www.ncsl.org/press-room/ncsl-thanks-senators-for-passing-marketplace-fairn.aspx (last accessed May 10, 2013).
3. Ill.Rev.Stat. c. 120, 439.2 (1965).
4. N.D. Cent. Code §57-4.2-01(6) (Supp. 1991).
5. State ex rel v. Quill Corp., 470 N.W.2d 207, 208 (N.D. 1991).
6. Quill Corp. v. North Dakota, 504 U.S. 298, 318 (U.S. 1992).
7. http://www.census.gov/compendia/statab/2012/tables/12s1055.pdf (last accessed May 12, 2013)
8. http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf (last accessed May 12, 2013)

Continued on page 38

Religious Workplace *Cont'd from page 37*

Title VII, 42 USC §2000e-2(a)(1) & (2).
16. Harris v. Forklift Systems, Inc., 510 U.S. 17 (1993).
17. *See* Burlington Indus. v. Ellerth, 524 U.S. 742, 765 (1998); Faragher v. Boca Raton, 524 U.S. 775, 807 (1998).
18. *Harris,* 510 U.S. at 21.
19. See http://www.eeoc.gov/eeoc/statistics/enforcement/charges.cfm
20. 548 U.S. 53 (2006) (held, the anti-retaliation protections of Title VII are not limited to actions and harms that are related to employment or occur at the workplace. Title VII's anti-retaliation protections extend to employer actions that would have been materially adverse to a reasonable employee or job applicant).
21. Clark County v. Breeden, 532 U.S. 268 (2001).
22. *E.g.,* Anderson v. U.S.F. Logistics (IMC), Inc., 274 F.3d 470, 476 (7th Cir. 2001).
23. Wilson v. U.S. West Communications, 58 F.3d 1337 (8th Cir. 1995) and Peterson v. Hewlett-Packard Co., 358 F.3d 599 (9th Cir. 2004). ML

Code Enforcement *Cont'd from page 27*

such ordinance provides that anyone hauling garbage or debris within the city must be licensed for such activity and follow certain guidelines. If I were a betting man, I would bet that no landlord or customer has such a license to haul garbage or debris away from their property to another location. The other ordinance that should be more of a deterrent is our vehicle seizure and impoundment ordinance. The offense of illegal dumping is one of the violations that will result in the seizure and impoundment of the vehicle.

As with any code enforcement ordinance or issue, we are hoping for compliance versus continual enforcement. Our community has come a long way in dealing with litter, garbage and related issues. Our citizens continue to comment that the City looks better now than it ever has. And, with periodically reviewing and updating our ordinances, we are hoping to continue that trend.

Happy Summer Everyone! ML

Federal *Cont'd from page 21*

9. *Id.; Forrester Research predicted in 2010 that the $250 billion number would be achieved by 2014, but even that forecast was overly conservative:* http://techcrunch.com/2010/03/08/forrester-forecast-online-retail-sales-will-grow-to-250-billion-by-2014/ (last accessed May 12, 2013)
10. N.Y. Tax Law §1101(b)(8)(vi)
11. http://www.boe.ca.gov/lawguides/business/current/btlg/vol1/sutr/1684.html (last accessed May 12, 2013); Cal. Rev. and Tax Code §6203, ch. 313 (6).
12. Overstock.com, Inc. v. New York State Dep't. of Taxation and Fin., no. 33 (N.Y. Mar. 28, 2013) http://www.nycourts.gov/ctapps/Decisions/2013/Mar13/33-34opn13-Decision.pdf (last accessed May 13, 2013)
13. http://www.cbiz.com/page.asp?pid=9111 (last accessed May 13, 2013)
14. A companion bill (H.R. 684), was introduced in the House in February 2013, also with bipartisan sponsorship: Republicans Steve Womack (R-Arkansas) and Kristi Noem (R-South Dakota) joined Democrats Jackie Speier (D-California), John Conyers (D-Michigan) and Peter Welch (D-Vermont).
15. S.743 113rd Cong. (2013); text at http://thomas.loc.gov/cgi-bin/query/D?c113:2:./temp/~c113dUmWNe: (last accessed May 13, 2013
16. National Bellas Hess v. Department of Revenue of Ill., 386 U.S. 753, at 759-60 (1967).
17. http://www.marketplacefairness.org/what-is-the-marketplace-fairness-act/ (last accessed May 10, 2013)
18. http://www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20As%20Amended%205-24-12.pdf (last accessed May 13, 2013)
19. Those states include Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin and Wyoming.
20. http://www.forbes.com/sites/peterferrara/2013/05/02/overreaching-internet-sales-tax-is-obamas-calculated-deception-of-gullible-voters/ (last accessed May 11, 2013) ML

Inside Canada *Cont'd from page 21*

but only to those individuals who do so in pursuance of trade, calling business or occupation. Persons who perform or participate in a performance at a facility while nude or partially nude for reason other than commercial activity related to adult live entertainment are not "entertainers" for the purpose of the licensing provisions. *2211266 Ontario Inc. v. Brantford (City)* (May 8, 2013), Doc. CA C56299, Doherty, Cronk, Lauwers JJ.A. (Ont. C.A.)

Termination of Employment by Municipality During "Lame Duck" Period

Municipalities are prohibited by s. 275 of the Municipal Act, 2001 from taking certain actions during the "lame duck period" unless the power to do so has been properly delegated prior to the nominations day. Among these restricted actions is the hiring and dismissal of employees. The applicant employee was terminated from her employment with the respondent municipality during the 2010 election period. The dismissal was delegated to and conducted by senior staff members in accordance with the respondent county's policy, which was adopted by the respondent's council in 2005 (but not by by-law). The applicant sought a declaration that the termination of her employment violated s. 275 of the Municipal Act, 2001 and was unlawful. The applicant submitted that pursuant to s. 5(3) of the Municipal Act, 2001 the hiring and firing of employee's is a power that must be exercised by by-law unless the municipality is authorized to do otherwise. The applicant argued that while the county had the general power to delegate to hire and fire employees, such delegation must be authorized by by-law. The respondent county's policy under which the power to hire and terminate employees was delegated and was not adopted by by-law. The applicant submitted that only the county council could dismiss an employee. The issue on application was whether the respondent county's policies were properly enacted such that the power to hire and dismiss employees was delegated to senior management prior to the nominations day of September 10, 2010.