Policy Brief
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Having it Both Ways on Sales Taxes

After court ruling, true reform sidelined as state adjusts to Internet era

On June 21, the U.S. Supreme Court released a major ruling affecting Internet sales taxes that immediately raised questions about how much new revenue Louisiana state and local governments might expect to gain. The court's decision on *South Dakota vs. Wayfair* momentarily disrupted the 2018 third special session in the Louisiana Legislature, but its impact on the state's sales tax system could be a lasting one.

Here's an early-stage analysis of what the court ruling might mean for state revenue, retailers, e-commerce, the state's tax collection system and potential lawsuits. Most importantly, we should keep in mind the ultimate goal of reforming Louisiana's highly decentralized, non-uniform and exemption-ridden sales tax system.

MAJOR POINTS

In summary, the outlook at this stage points to several key observations:

- Based on a series of recent Louisiana laws and other developments, the state intends to move quickly to expand its collection of tax on remote sales transactions by Louisiana residents.
- Expectations of new revenue should be kept modest: Amazon and most major online retailers already collect and remit sales taxes for purchases shipped to customers in Louisiana. And some newly taxable online purchases will merely replace traditional retail purchases, with no new net tax revenue realized.
- Motivated by the new legal environment or business reasons, some online retailers not currently collecting sales taxes for Louisiana purchases might be expected to begin doing so in the near future. They may do this whether or not Louisiana takes steps to achieve greater sales tax uniformity and other streamlining reforms.
- Louisiana is developing two separate systems for sales and use tax collections, providing a relatively easy and centralized path for remote "Internet" sellers while keeping the old decentralized system for traditional brick and mortar in-state retailers and other businesses. This bifurcated system is expeditious but eventually could encounter legal and policy problems.
- In the past, tax experts speculated that Congress or a major court decision sooner or later would embrace a new set of e-commerce standards among the states that would force Louisiana into a streamlined, 21st Century method of handling all its traditional as well as online sales tax transactions. The new circumstances ironically could lead local governments to become further entrenched in their protection of the

status quo, and the state's economic environment would continue to be burdened by the baroque rules and jurisdictions of our sales tax structure.

- Alternatively, new policies or unexpected court cases in the new legal era could pose challenges to the old Louisiana way, with an eventual breakthrough for real reform. State leadership will be the key.

THE RULING

In the milestone case of *South Dakota vs. Wayfair*, the Supreme Court voted 5-4 to overrule a 1992 Supreme Court decision known as *Quill Corp. vs. North Dakota.* The case was remanded to the state court for further proceedings. For all these years under *Quill* and related legal decisions, a seller generally was not required to collect and remit a sales tax on a purchase unless it had some physical presence, or "substantial nexus," in the state of the buyer. The new standard under *Wayfair* evaluates whether a seller has "an extensive virtual presence" within a state, a novel concept. Many online stores and e-marketplace vendors fit that definition wherever they sell across the country and now will become liable for sales taxes even if they do not have a physical presence in a purchaser's state.

However, the court in *Wayfair* also recognized that a state's tax system cannot discriminate against or place undue burdens upon interstate commerce, a protection based in the U.S. Constitution. Interstate commerce is regulated by Congress, not the states. The Supreme Court looked for features in South Dakota's new tax system that would indicate the state is not interfering with interstate commerce.

First, the court said South Dakota provides a safe harbor for remote companies transacting only small amounts of business in the state. As evidence of this, the court pointed to the South Dakota law that says only sellers of more than $100,000 in goods or services or which engage in 200 or more transactions yearly are liable for the sales taxes. Louisiana shares this feature because the Legislature, anticipating the *Wayfair* ruling, passed a law duplicating this South Dakota threshold during the second special session.

Second, the court observed that South Dakota would not apply its new Internet sales tax retroactively. Louisiana would share this feature also.

Third, the court identified several features of the South Dakota system by virtue of the state's membership in the Streamlined Sales and Use Tax Agreement, which is joined by more than 20 states to reciprocate and cooperate on sales tax transactions. States under the agreement have standardized taxes to reduce administrative and compliance costs. In particular, the court noted that the system requires: a single, state-level tax administration; uniform definitions of products and services; a simplified tax rate structure; and access to sales tax administration software provided to sellers at state expense.

Amazon and most major online retailers already collect and remit sales taxes for purchases shipped to customers in Louisiana.

Louisiana is not a party to the multi-state streamlined tax compact, but the court did not say that membership would be a requirement for a state to receive sales taxes from remote sellers. Perhaps more importantly, under guidance from the *Wayfair* ruling, non-member states like Louisiana will be looking to adopt those attributes listed by the court to make a case that they too – like South Dakota -- are eligible to raise revenue from Internet sales transactions.

A BROKEN SYSTEM

Louisiana will argue that taxes upon remote sales to state residents are handled by a single, state-level tax administrator under a simplified tax rate structure. To those familiar with Louisiana's jungle of a sales tax system, that argument might seem implausible. Each parish in Louisiana oversees its own sales tax collection, audits, rates and even interpretations of what is taxed. No other state has this degree of local independence and control of its sales tax system. Louisiana has an unusually large number of exemptions and exclusions, and state and local governments lack uniformity about what is taxable.

Critics of the Louisiana system have maintained that Louisiana's sales tax structure and administration are inefficient, cumbersome and unfair for business. The Tax Foundation in Washington, D.C., ranks Louisiana's sales tax system last among the states in its Business Climate Index. Local government power over the system is vested in the state Constitution. Local authorities have legitimate concerns about their jurisdictional revenue streams, because most parishes and municipalities are abnormally reliant on sales taxes versus property taxes compared to local governments in other areas of the nation.

Louisiana is developing two separate systems for sales tax collection.

The current state level tax is 5%, dropping to 4.45% on July 1. Local sales taxes vary among parishes and municipalities but average about 5%. Louisiana has held the No. 1 ranking with the nation's highest overall sales tax rate of 10%, which now may drop to second place or a virtual tie for first with Tennessee. Such a large reliance on sales taxes creates greater volatility compared to government revenues based on property taxes, which tend to be more stable. Sales taxes are more sensitive than property taxes to disasters and major disruptions.

In summary, if Louisiana had to meet the Supreme Court's implied standards for a streamlined and efficient sales tax system, it would surely fail. Louisiana's revenue secretary said the state does not meet the streamlining standards implied by the Supreme Court, and that a "significant revamp" is needed. But here's what the public needs to understand: Louisiana's archaic, decentralized system will not apply to many remote Internet vendors. We have a new, different system for them.

LOUISIANA'S ANGLE

Piece by piece, the state has put together a new regime for these remote transactions, separated from the traditional system by rates and administration. The Louisiana Sales and Use Tax Commission for Remote Sellers will meet for the first time on June 29. Through legislation last year and this spring, this newly created body within the Department of Revenue was designed to rise to the current occasion. Originally it was supposed to help the state comply with a prospective new Internet sales tax law out of Congress, but Congress has yet to act. A bill in the second special session allowed the commission to start if the Supreme Court rendered a ruling such as *Wayfair*. The new system is ready to launch.

The commission will perform as a single entity for handling revenue from remote sales transactions. The state revenue department has been playing a similar role up to now, based on an old law originally aimed at collecting taxes on retail catalog sales. The tax rate for these transactions is 9%. The state gets 5% and the local governments get 4%. Currently, the local distribution of revenue is made according to population. The most recent quarterly distribution to local governments was only $890,000. Under the new commission, the intent is to distribute the local revenue according to the zip codes of online purchasers. From the state's share, up to 1% can be used to finance tax board operations. Also, the state has created a Louisiana Uniform Local Sales Tax Board, a state body of local officials that began meeting last year.

Another recent state law requires remote online sellers to notify its buyers in Louisiana of the taxes owed for purchases that the seller did not collect. This aggressive move, passed in 2016 and implemented last year, compelled some retailers to begin collecting sales tax to avoid the complications of these customer notifications. Amazon, by far the largest online retailer with more than $100 billion in U.S. e-commerce sales, signed a "voluntary collection agreement" with the state last year to begin tax collections. *[See endnote]*

The state now has an optional process for local tax disputes through the Board of Tax Appeals. Plus, the Legislature's new sales tax renewal bill "cleans" all the sales tax pennies; although more than 100 exemptions will remain on the books, numerous exemptions will no longer be allowed on the standard state sales tax. As for the state's ability to provide sales tax administration software to remote sellers, this task should pose no major obstacle because this wheel has already been invented for other states.

These new structures may serve to put a better face on Louisiana's bid for legally charging taxes on most remote sales. Ironically, in the name of streamlining, Louisiana has created a whole new parallel layer of government with new commissions and separate rules. Still, a strong argument will be made that, because of this, Louisiana will be administratively and legally ready to expand remote sales taxation in as short a time as possible. As envisioned under this new state system after *Wayfair*, much of the previously uncollected revenue from Internet sales is now destined for state and local tax coffers.

WHEN AND HOW MUCH?

So, when will we see results? And what's the size of the impact?

This is the one thing we know for sure that we don't know for sure. As the Legislative Fiscal Office put it in a Mr. Spock kind of way, "Any particular estimate of the magnitude and timing of possible additional collections is speculative."

The answers will evolve over time. The outcomes will depend on the unilateral actions of the online retailers, the state's ability to administrate the new collections, and the legal standards that will come into play particularly for Louisiana.

As cited by the Supreme Court decision, the U.S. Government Accountability Office released a report in November 2017 about the revenue states might gain from expanded authority to collect sales taxes from remote sellers. Based on 2017 data, the GAO estimated that state and local governments would have gained $8 billion to $13 billion that year, representing 2% to 4% of total general sales and gross receipts taxes. For Louisiana, the gain would have been $195 million to $288 million if the new authority could have been fully realized for both state and local sales tax revenue.

While those are impactful amounts of money, they would represent a modest percentage increase in the current level of Louisiana's state sales tax collections, estimated at $4 billion for the next fiscal year. One reason is that most of the major online retailers selling in the United States already collect and remit sales taxes. Among the top 100 companies followed by the Internet Retailer, the seller collection rate was 87% to 96%, according to GAO's analysis. That means most of the major online vendors already process sales taxes in most of their markets.

THE MAJORS ALREADY COLLECT

PAR found similar results reviewing 32 of the largest online direct retailers with at least $1 billion in e-commerce sales in the United States, based on industry data. The great majority of these vendors have stores in Louisiana and therefore already charge sales tax for their online purchases here. Wal-Mart, Apple and Macy's are examples of those. Retailers with a Louisiana physical presence remit sales taxes through the local collection system, even if selling online. This process can prove awkward and complicated for those companies, who are at a disadvantage to the remote sellers using the state's newer centralized system. As of last week, only five of these 32 online retailers indicated that they skip sales tax charges for products shipped to Louisiana, representing about 4% of all these retailer's U.S. Internet sales. These non-collectors are likely to become collectors fairly soon. If a company the average size of one of these five retailers started collecting tax, and assuming its Louisiana sales were proportional by population to its U.S. sales, then Louisiana could expect about $1 million in new state tax revenue and about $840,000 in local tax revenue.

One of the largest non-collectors for Louisiana until very recently was Wayfair Inc., the home furnishings retailer that challenged the South Dakota law. The company just began handling sales taxes for purchases in Louisiana. Wayfair collects and remits sales tax on about 80% of its U.S. orders. That is a number "that continues to grow as we expand our logistics footprint," Wayfair said in a statement following the Supreme Court decision. The company had hoped that Congress, rather than the courts, would "establish a level playing field" for all retailers.

Critics of Louisiana's archaic system have maintained that the state's sales tax structure and administration are inefficient, cumbersome and unfair for business.

The Wayfair move is but one example of the trend among online direct retailers to capitulate to the practice of collecting sales taxes, and this trend may accelerate following the Supreme Court ruling. What this means is that Louisiana might expect a continued increase in the number of remote sellers collecting tax, even if the state were to ignore the court's guidance and fail to further streamline its sales tax system. The biggest player is Amazon, which dwarfs its competitors. After Louisiana passed the customer notification law in 2016 and the courts upheld a similar law in Colorado, Amazon signed a "voluntary collection agreement" with the state and began taking sales tax on Louisiana purchases in 2017. It is the single most valuable online vendor for that source of revenue.

GROWTH AND ADAPTION

In addition to new tax collectors coming onto the scene, the growth in online retail business also will increase this class of state revenue numbers. Analysts' estimates range from 10% to 19% annual growth in U.S. e-commerce. Amazon's total sales grew by $41 billion last year, or 33%. While these growth trends will be favorable to Louisiana's revenue from remote sellers, there could be offsets in the traditional sales tax arena as local store sales continue to migrate to online vendors. A number of major brick and mortar retailers are seeing their store sales stagnate or decline as their online purchases increase. The lesson is, a boon in online sales tax collections may not presume the same in overall collections.

Another class of online sellers is the e-marketplace vendors, such as eBay, that serve as a sales platform for thousands or even millions of small sellers. A portion of Amazon's enterprise is an e-marketplace, offering microbusinesses a global sales venue. Generally, e-marketplace transactions are less likely to include a sales tax collection, according to the GAO report. EBay and Etsy, an arts and crafts marketplace, both submitted briefs to the Supreme Court arguing against the wider taxing authority. The companies highlighted the difficulties of asking their sellers to collect taxes. "A typical Etsy seller is a female entrepreneur working out of her home to supplement her household's income. In 2017, 1.9 million such micro-entrepreneurs used Etsy to earn a total of $3.25 billion, including from sales across state and country lines," the brief said.

A boom in online sales tax collections may not show up in overall collections.

Specialty vendors are another type of online seller that typically do not collect sales taxes unless they have a clear physical presence in a state. These are small to mid-size retailers that serve a particular hobby, sport or line of business. Wall art, musical instrument strings, shaving razors, swim apparel, pond plants, scrap books, Christmas wreaths, pet supplies – the list goes on and on. These retailers – who typically will be competing against some of the major online sellers – may be the most concerned about the new Supreme Court ruling and the requirements for collecting and remitting taxes. Likewise, cashing in on these retailers could be complicated, time-consuming and maybe even legally challenging for the state. The state's cost of enforcing compliance, if it chooses to do so aggressively, could be high.

LAWS AND LAWSUITS

For many players in the national discussion of online sales taxes, an act of Congress has been seen as the best ultimate solution to create a level playing field. The proposed Marketplace Fairness Act is one of those vehicles but has been tied up for years. The prospect of Congress moving forward has been dim, but possibly the Supreme Court ruling will spark progress. Lawmakers might wish to protect small businesses in particular. The debate pits differing interests and values, such as major versus minor retailers, or those who see the online tax as fair versus those who see it as a new and onerous grab by government.

The day does not appear to have come quite yet when a new national standard for sales taxes would compel Louisiana to adopt a more efficient centralized system as is done in virtually every other state. We have a two-track system: out-of-state online retailers get a simple centralized process, while local brick and mortar retailers are left with the same archaic and inefficient system hostile to business activity. We may now realize online sales taxes remitted by remote sellers like never before, but we may be able to do so without any real change to our underlying, traditional sales tax collection system. The carrot for sales tax reform was always the prospect of better or more stable revenues, which would appeal to mayors, sheriffs, school boards and parish leaders. Now, they may get the carrot without the incentive for reform.

For the moment, Louisiana local governments continue to hold tightly to the traditional decentralized system. Parishes will continue to collect, audit and even interpret their own guidelines for charging sales taxes on local businesses, even if that means some businesses will be operating under different rules for different jurisdictions and undergoing multiple audits. Local authorities have concerns that a state-centralized collection system would prove to be more error-prone and perhaps even create cash flow problems. Their huge dependence on the sales tax makes them all the more wary of change or loss of control.

Short of an act of Congress, Louisiana's sales tax system could encounter lawsuits that further determine the state's direction. While the Supreme Court case involved a suit with major online retailers, the future could hold legal disputes among the state, local governments, small online retailers, in-state vendors, e-marketplace platforms or even just a common purchaser. Louisiana's two-track sales tax system – with its online component and its decentralized traditional system, plus its evident lack of uniformity, sales tax holidays and other idiosyncrasies – would seem to be ripe for arguments over fairness. Whether these conditions will lead to more court rulings defining or disrupting Louisiana's future path is a question mark that will not be answered right away.

A truly modern centralized system is the goal.

While the current focus is on the potential near-term state revenue impact of this court decision, we should not lose sight of the longer-term policy considerations and fiscal effects for state and local governments. A truly modern centralized and streamlined system for all retailers should be the state's eventual goal. That is the biggest prize, as it would improve Louisiana's business climate. State leaders need not wait for the courts and Congress to be the catalyst for that reform.

Endnote

The term "sales and use taxes" is often used to describe the category of taxes applied to the obtainment of goods or services. Louisiana recognizes nuanced differences between a sales tax and a use tax. The Supreme Court's Wayfair ruling left this distinction in somewhat of a gray area. In its brief to the Supreme Court, the Cato Institute noted that "use taxes" are so-named because they are applied not to the sale of goods but to the use, storage, or other consumption of tangible personal property within the taxing state. The use tax was developed to complement and to prevent evasion from sales taxes, such as when a purchase in a non-taxing state is shipped into a taxing state. Cato advised the court that South Dakota could increase compliance with its existing use tax regime, as many other states had done.

In Louisiana, when a sales tax is not charged for a remote online purchase, taxpayers are supposed to report the taxes owed on their income tax returns and pay a use tax on them. The rate is 9%, which would be the same as the sales tax that wasn't collected at the time of the online purchase. Taxpayer compliance is lax. So, a Louisiana law passed in 2016 requires out-of-state retailers that deliver non-taxed goods to Louisiana customers to notify the shoppers the items are subject to the state use tax. The annual notice letters are supposed to detail the dates and amounts of purchases made the previous year, along with a "clear statement that Louisiana use tax may be due." Retailer compliance with that law could be expensive and cumbersome, and so some online sellers have simply agreed to collect and remit a sales tax to Louisiana.

Public Affairs Research Council of Louisiana
451 Florida Street, Suite 1060, Baton Rouge, LA 70801

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