No. 17-494

In The
Supreme Court of the United States

SOUTH DAKOTA,

Petitioner,

v.

WAYFAIR, INC., OVERSTOCK.COM, INC. AND NEWEGG, INC.,

Respondents.

On Writ Of Certiorari To The Supreme Court Of South Dakota

BRIEF OF THE AMERICAN ACADEMY OF ATTORNEY – CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICUS CURIAE*[1]

Amicus is the American Academy of Attorney – Certified Public Accountants, Inc. ("AAA-CPA"), a not-for-profit corporation formed in 1964. The AAA-CPA has members located throughout the United States. Every member has, at some time in his or her career, been licensed as both an attorney and a certified public accountant.

AAA-CPA members, with both accounting and law backgrounds, have unique perspectives on business and the courts. At the same time, a significant number of the AAA-CPA members have devoted their careers to the fields of federal and state tax law, representing a very wide variety of industries. As such, AAA-CPA members have first-hand knowledge of the challenges facing a business when having to engage in multijurisdiction sales tax and use tax compliance and just how difficult it is for a business to defend against sales tax audits and assessments. Because of these qualifications, AAA-CPA has a compelling interest in this Court's ruling.

[1] Pursuant to Supreme Court Rule 37.2, Petitioner and Respondents have granted blanket consent to *amicus* briefs. Letters are on file with the Clerk. Pursuant to Supreme Court Rule 37.6, counsel for *amicus* represents that it authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *amicus*, its members, or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief.

SUMMARY OF THE ARGUMENT

Petitioner, South Dakota ("South Dakota" or "State") attempts to persuade this Court that a sales tax economic nexus law merely requires remote sellers to collect sales tax and such compliance is both simple and free. What's amazing is that everything in this last sentence is wrong. When a remote seller is found to have nexus, the seller must not only begin to collect sales tax for that state, but the business will also become liable for those taxes. That means the remote seller is liable for every mistake and missing or incorrect documentation.

The purpose for adding the Commerce Clause to the United States Constitution[2] was to prevent a state from taxing and regulating interstate commerce purely for the benefit of increasing its own state tax revenue without regard for the economic well-being of the country. South Dakota, claiming a dire need for revenue, has asked this Court to allow a broad jurisdictional reach over remote sellers to collect taxes that the State's own citizenry has been unwilling to pay. South Dakota's blatant disregard for the real and complex burdens inherent in multistate sales tax compliance, simply for the sake of increasing state tax revenue, is the epitome of what the Commerce Clause is designed to prevent.

The AAA-CPA respectfully requests this Court consider the sales tax compliance burdens discussed

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[2] U.S. CONST. art. I, § 8, cl. 3.

below that will be imposed on remote sellers if *Quill*[3] is overturned. The vast expansion of sales tax jurisdictions and the growing complexity of sales tax laws over the last fifty years, have made the burdens of multistate sales tax compliance greater now than when this Court originally ruled that state laws imposing taxation on retailers with no physical presence in the state violated the Commerce Clause.

ARGUMENT

I. SOUTH DAKOTA SIGNIFICANTLY UNDERSTATES THE UNCONSTITUTIONAL BURDENS PLACED ON REMOTE SELLERS TO COMPLY WITH SALES TAX LAWS AND REGULATIONS.

A. With Almost 10,000 State and Local Jurisdictions in the United States, Sales Tax Compliance is Much More Burdensome Than a Click of the Mouse and Electronically Filed Returns.

South Dakota raises the same argument made in *Quill*, that advances in technology will ease the burden of complying with the multitude of tax-hungry jurisdictions. However, this argument fails to consider that the sales and use tax laws are constantly growing in the number of taxing jurisdictions and the complexity of laws to determine what is, and what is not, taxable. To make matters more complicated, these laws and

[3] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

regulations are regularly amended, altered by agency rulings, and re-interpreted by the courts. If South Dakota's statute[4] is held constitutional, then remote sellers will have to keep up with the sales and use tax laws and regulations in not only forty-five states,[5] but also in nearly 10,000 individual jurisdictions[6] that have their own laws and regulations. Many of the local jurisdictions even require their own sales tax returns. Without a physical presence in the states, staying current with these sales tax laws and regulations would be, by itself, a significant and costly burden on multistate businesses.

Advances in software have helped businesses determine sales tax rates by inputting their customer's zip code. But math has never been the hard part of taxation. The difficulty of any tax is determining what is taxable, what is not taxable, what steps and documentation are required to make a sale exempt, and the laborious process of making these decisions before each transaction. Software does not make these decisions for remote sellers. Furthermore, remote sellers become liable for every mistake and missing piece of documentation. The states, including South Dakota, know just how difficult the sales tax compliance process is for

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[4] S.D. CODIFIED LAWS § 10-64-2 (Supp. 2017).

[5] Alaska, Delaware, New Hampshire, Montana, and Oregon do not have a state sales tax, although some local jurisdictions do have a sales and use tax in some of these states.

[6] *See* Jared Walczak, Scott Drenkard, & Raymond Roesler, *Sales Tax Rates in Major Cities Midyear 2017*, TAX FOUNDATION (July 2017), https://taxfoundation.org/sales-tax-rates-major-cities-midyear-2017/.

remote sellers, which is why they target out of state businesses for sales tax audits.

In *Complete Auto Transit v. Brady*, this Court laid out a four-prong test for the constitutionality: there must be substantial nexus with the taxing State, fairly apportioned, not discriminatory towards interstate commerce, and is fairly related to the services provided by the State.[7] South Dakota's new law, however, violates these principles. For example, products transferred electronically into the state are subject to the sales tax under the new law. This could be narrowly tailored to mean electronic products delivered to the end consumer are subject to the sales tax, or could be more broadly interpreted by the state to mean electronic products merely passing through a server located in the state are now subject to the sales tax. In the case of the latter, this could potentially mean that the same sale could be taxed by South Dakota and any number of the thousands of jurisdictions that impose a sales tax, without any apportionment of the sale or limit on who can subject the sale to sales tax.

B. With States Having Almost Unlimited Power to Estimate Sales Tax Liabilities, Remote Sellers Face "Guilty Until Proven Innocent" Sales Tax Audits.

The States have legislated to themselves the power to estimate the sales tax liabilities of a business if the State determines or suspects that all the records

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[7] *Complete Auto Transit v. Brady*, 430 U.S. 271 (1977).

have not been provided.[8] These estimating techniques often involve very high estimated assessments that have the statutory presumption of correctness. The taxpayer has the burden to establish why the assessment is incorrect to avoid paying tax,[9] resulting in a "guilty until proven innocent" tax on businesses. To overcome an audit and likely assessment, a business must maintain meticulous documents, hire professional counsel licensed and qualified to respond to the audit, spend business hours on voluminous auditor requests, and potentially have a hearing on disputed issues. On average, a negative audit costs small to medium size businesses over one hundred thousand dollars.[10] Given that an audit often takes years to get resolved, remote sellers will spend substantial time and resources responding to taxing authorities, rather than building a successful business.

Under an economic nexus regime, remote sellers would, therefore, absorb the time and significant expense of complying with each jurisdiction's regulations, and responding to multiple sales and use tax audits every year. These burdens would lead such retailers to simply stop engaging in out-of-state sales. This hinderance on interstate commerce in favor of

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[8] *See, e.g.*, FLA. STAT. § 212.12(5)(b), (6)(b) (allows the state to use "best available information" to estimate liabilities).

[9] *See, e.g.*, FLA. STAT. § 120.80(14).

[10] Avalara and Peisner Johnson & Company, *Sales and Use Tax Audits Uncovered: Who gets audited, why they get audited, and the impact on companies* (2017), peisnerjohnson.com/wp-content/uploads/2017/09/Sales-and-Use-Tax-Audits-Sales-and-Use-Tax-Audits-Uncovered_02-14-17.pdf.

in-state economic interests is exactly the harm the Commerce Clause is designed to prevent.[11]

C. By Focusing on "Gotcha Tax Audits," States Target Remote Sellers for Sales Tax Audits, Taking Hundreds of Millions of Dollars a Year from our Nation's Most Valuable Industries.

South Dakota fails to mention in its brief that years after a sale has taken place and the sales tax collected has been remitted, the remote seller will be subject to a sales tax audit by every state where the company is deemed to have economic nexus. Sales tax audits are conducted every three to five years and cover as many years as the state's statute of limitations will allow. South Dakota does not raise in its brief the vast resources that multistate businesses devote to sales tax audits in multiple states. Nor does South Dakota mention that states target companies that are expected to be making mistakes in sales tax compliance. With different rules in each of the thousands of jurisdictions, it is easy for remote sellers to miss small differences in the sales tax exemption requirements. These mistakes often involve documenting and proving that a sale of a good or service is tax-exempt, which

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[11] *National Bella Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 759-60 (1967) (a burden on interstate commerce results from the "many variations in rates of tax, in allowable exemptions, and in administrative and record keeping requirements [that] could entangle [a mail order house] in a virtual welter of complicated obligations.") (footnotes omitted).

is something the "free" software does not do for companies. As discussed above, when a remote seller cannot prove a sale is exempt, then the remote seller is liable for the tax even though the tax was never collected from the customer.

South Dakota also does not admit that all states with a sales tax target out of state companies with high exempt sales. Tax professionals generally refer to these as "gotcha tax audits." The phrase is used when a company makes tax-exempt sales but technically fails to qualify for the exemption because it either uses the wrong form, is missing a notary, or has some other jurisdictionally specific defect. These gotcha tax audits result in hundreds of millions of dollars of sales tax assessments against a wide variety of industries in the United States. Taxes that were never collected from customers.

South Dakota alone generates an average of more than $10,000,000 per year from subjecting remote sellers to sales tax audits.[12] Florida averages over $200,000,000 per year auditing businesses with approximately two-thirds coming from audits of companies outside Florida.[13] Even as far back as 1998, the California legislature was allocating funds to sales tax auditors based on an expected rate of return equal to $5 of sales tax assessed from businesses to $1 spent on

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[12] *See* South Dakota Department of Revenue, 2016 Annual Report, pg. 35.

[13] Statistics of Florida's audit process provided to the AAA-CPA counsel of record, Moffa, Sutton, & Donnini, PA, upon Freedom of Information Request.

auditors, collectively taking more than $409 million of tax assessments from businesses that year alone.[14] In other words, states consider auditing out of state companies to be revenue generators for the state. If economic nexus laws like the one enacted by South Dakota are upheld by this Court, then remote sellers across the U.S. will become the targets of sales tax audits even though no employee or owner of the company resides or votes in the remote states. What should be alarming is that, manufacturers, our nation's most prized industry, is a prime target of these "gotcha tax audits" because almost all sales by manufacturers are supposed to be tax-exempt.

If South Dakota's economic nexus law is upheld, wholesalers and manufacturing companies must either spend enormous resources to hire tax professionals and properly document tax-exempt sales in almost 10,000 jurisdictions or risk incurring substantial taxes, penalties, and interest for transactions that were never supposed to be taxed in the first place. This is the essence of burdening interstate commerce and such costs are likely to be a deciding factor in whether a manufacturing company opts to locate in the United States in the first place. If burdens placed on manufacturers on transactions that were never intended to be taxed affect whether manufacturing jobs are created in the U.S., would this not be a decision required to be

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[14] California State Auditor, State Board of Equalization, *Budget Increases for Additional Auditors Have Not Increased Audit Revenues as Much as Expected* (Mar. 1999).

left to Congress under the Dormant Commerce Clause?

Of upmost importance to this case, under the bright-line physical presence test of *Quill*, wholesalers and manufacturing companies only have to comply with audits in states where they are located and will not be subject to "gotcha tax audits" by remote states. This is one of the many reasons why this Court's physical presence test is well aligned with the economic burdens of sales tax.

II. UNLIKE INCOME TAX, SALES TAX IS A TRUST FUND EXPOSING REMOTE SELLERS TO EXTREME CIVIL AND CRIMINAL LIABILITIES (100+ YEARS OF JAIL TIME) FOR SIMPLE BUSINESS FAILURES WITH NO BANKRUPTCY PROTECTION.

Unlike income tax, sales tax is considered property of the state held in trust by the remote seller at the moment the sales tax is collected from customers.[15] This slight difference has profoundly different consequences in how remote sellers and their owners are responsible for sales tax liabilities of the business. Many states impose severe civil and criminal penalties for minor violations of sales and use tax laws. While income taxes many be dischargeable or compromised in bankruptcy, the trust fund liabilities of sales tax are not. Therefore, even if a retailer manages to integrate software, hire enough qualified personnel to respond to

[15] *See, e.g.*, FLA. STAT. § 212.15(1).

audits, handle the research of what is subject to tax in every sales tax jurisdiction, and prepare the sales tax returns across the country, the company and its owners must still contend with potential liability for minor mistakes or business failures. When an average of 8 out of 10 businesses fail within five years,[16] state laws imposing harsh civil and criminal penalties for sales tax on the owners of a failed business can have a profound impact on interstate commerce.

The statute of limitations for sales tax audits in most states is limited to three years and six years for substantial underreporting.[17] However, the statute of limitations varies from state to state. Similar to income tax returns, if no return is filed, states have an unlimited statute of limitations. This means that if economic nexus is approved by this court, then every remote seller could have a potential undisclosed sales tax liability in thousands of jurisdictions just because they accept orders from around the country.

A. States Have Broad Powers to Impose Significant Civil Penalties and Pierce the Corporate Veil for Even Minor Sales Tax Mistakes.

If South Dakota's economic nexus statute is held to be constitutional, then remote sellers and their

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[16] *See* Eric T. Wagner, *Five Reasons 8 out of 10 Businesses Fail* (Sept. 2013).

[17] Sales Tax DataLINK, *Statute of Limitations and Sales Tax* (June 2012), http://www.salestaxdatalink.com/blog/statute-of-limitations-and-sales-tax.

owners will be at the mercy of 45 states' harsh civil penalties often for simple mistakes in sales tax compliance.

For example, in Florida each owner and responsible party is subject to a personal penalty equal to 200% of the sales tax owed by a business, which effectively pierces the corporate veil.[18] Florida is not unique with harsh sales tax laws. New York also pierces the corporate veil to impose a 200% of tax penalties on the responsible parties when the business is not able to remit sales tax.[19] It is a misdemeanor in New York for simply failing to show sales tax as a separate line item on an invoice.[20] New York also imposes fines up to $1,000.00 for simply failing to make records available in "auditable" form; and criminal penalties for failure to keep required records.[21] South Dakota imposes a $10,000 penalty for each return in which the sales tax data is deemed to have been altered.[22] If you challenge a South Dakota tax assessment in court and the position is "not justified," then the taxpayer owes the legal fees of the State.[23]

When a business is running at a loss and sales tax proceeds are kept in the same bank account with other

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[18] FLA. STAT. § 213.29.

[19] N.Y. TAX LAW § 1145(a)(2).

[20] N.Y. TAX LAW § 1817(d).

[21] N.Y. TAX LAW § 1145(j); N.Y. TAX LAW § 1817(g).

[22] S.D. CODIFIED LAWS § 10-59-55 (Supp. 2017).

[23] S.D. CODIFIED LAWS § 10-59-34 (Supp. 2017).

funds,[24] then simply paying the rent or paying employees results in sales tax proceeds unintentionally being spent each month. When the business fails after several months of not being able to pay sales tax, the act of unintentionally using sales tax trust funds to pay business bills is enough to have the harsh penalties imposed. The same situation is enough in most states to evoke criminal laws as well.

B. Criminal Punishments for Not Remitting Sales Tax in the Final Months of Business Are Startlingly Harsh.

The criminal punishments inherent in sales tax compliance are hazardous to business owners because sales tax is a trust fund liability not dischargeable in bankruptcy. The simple act of spending sales tax on business expenses and not having these funds available to timely remit is considered a criminal act. For example, in Florida, it is a felony, punishable by up to 5 years imprisonment and a $5,000.00 fine for collecting and not remitting merely $301 of sales tax and up to 30 years for not remitting $100,000 of sales tax.[25] Even in South Dakota, the failure to pay sales tax just twice in South Dakota is a felony punishable with up to two years in prison and $4,000 in fines. For a remote seller collecting sales tax in 45 states, a business

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[24] There is no requirement in any state to place sales tax into a separate bank account.

[25] FLA. STAT. § 212.12(2)(d)2.; FLA. STAT. § 212.13(2).

failure owing sales tax could result in over 100 plus years of potential jail sentence spread over multiple states.

These severe penalties for relatively minor mistakes highlight the importance of why businesses should not be subject to tax in a jurisdiction unless they maintain a physical presence there. If South Dakota's statute is held to be constitutional, the threat of civil and criminal penalties will either deter businesses from engaging in multijurisdiction commerce or will subject the owners and responsible parties to harsh, unforeseen civil and criminal repercussions.

C. Remote Sellers Subject to Class Action Lawsuits for Unintentional Over Collection of Sales Tax.

Remote sellers not only have to worry about civil and criminal penalties for not collecting and remitting enough sales tax, but they also now must worry about class action lawsuits from customers for unintentionally collecting too much sales tax. Companies such as Papa John's Pizza,[26] Pizza Hut,[27] B.J.'s Wholesale

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[26] *Schojan v. Papa Johns Int'l, Inc.*, Case No. 8:14-cv-1218-T-33MAP (M.D. Fla. 2015) (sued for collecting sales tax on delivery fees; settled out of court).

[27] *Minniti v. Pizza Hut of Am., Inc.*, Case No. 14-23335 (17th Cir. Ct. Fla. 2016) (sued for collecting sales tax on delivery fees; settled out of court).

Club,[28] Dell,[29] and a slew of other companies have all been hit with class action lawsuits for misunderstanding sales tax laws and over collecting sales tax.[30] These lawsuits are over pennies of tax per customer and the taxes have all been remitted to the states. Nonetheless, courts are allowing the suits to continue with enormous legal costs to the defending companies. If companies the size of these cannot get sales tax collection correct with software, then South Dakota's assertion that advances in technology make sales tax simple must not be believed. If this Court allows the substantial nexus requirement to be met by economic nexus for sales tax purposes, then every remote seller in the U.S. could be subject to potential class action suits in multiple jurisdictions for minor mistakes in sales tax compliance.

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[28] *Bugliaro v. BJ's Wholesale Club, Inc.*, Case No. 15-006256-CA-01 (17th Cir. Ct. Fla. 2015) (sued for not properly calculating sales tax on transactions with coupons).

[29] *Mohan v. Dell*, Case No. CGC 03-419192, CJC 05-004442 (Sup. Ct. of Cal., Cty. of San Fran. 2013) (sued for not properly charging use tax on purchases of optional service contracts; settled out of court).

[30] *See* Thomson Reuters, *Damned if You Collect, Damned if You Don't: Retailers Caught Between Consumer Class Action and Qui Tam Claims*, JOURNAL OF MULTISTATE TAXATION AND INCENTIVES (Vol. 24, No. 7, Oct. 2014).

III. CONGRESS MUST ESTABLISH A UNIFORM SYSTEM OF SALES AND USE TAX REGULATIONS BEFORE STATES CAN BURDEN INTERSTATE COMMERCE.

The subject matter of this lawsuit requires a uniform system between states. In such circumstances, the powers under the Commerce Clause vest exclusive authority in Congress to control the matter.[31] A significant, manifest burden to interstate commerce would result from granting states the ability to, essentially overnight, audit and assess sales and use tax based on the economic presence of a business. Because a uniform system is necessary, allowing states to control sales tax based on economic presence would lead to an unlawful encroachment upon the regulation power conferred solely with Congress.[32] The refusal of Congress to pass legislation since *Quill* should not be the basis for allowing states to encroach upon the regulation power vested fully in Congress.[33]

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[31] *Leisy v. Hardin*, 135 U.S. 100, 108-09 (1890) ("Where the subject matter requires a uniform system as between the States, the power controlling it is vested exclusively in Congress, and cannot be encroached by the States.").

[32] *Cunard S. S. Co. v. Lucci*, 228 A.2d 719 (N.J. Super. Ct. App. Div. 1967) (allowing states to regulate subject matter that is national in scope would lead to conflicting and different regulations. Because of this undue burden, the Commerce Clause excludes attempted state regulation).

[33] *Welton v. Missouri*, 91 U.S. 275 (1876) (Congressional inaction "is equivalent to a declaration that interstate commerce shall be free and untrammeled.").

Some states have recognized the need for uniform sales and use tax regulations, as evidenced by the development of the Streamlined Sales and Use Tax Agreement ("SSUTA"). The SSUTA is a multistate effort to standardize and streamline the administration of sales tax. However, although SSUTA has made progress in reducing compliance burdens, only twenty-four states, representing 33% of the U.S. population have passed legislation conforming to SSUTA.[34] The lack of conformity among States again shows the need for a uniform system of regulation prior to overruling *Quill*. Because uniform regulation is necessary, the burden is on Congress to pass legislation.[35]

CONCLUSION

The AAA-CPA believes as this Court did in *Quill* that this matter is much better left for Congress to create a law that takes the interests of all parties into consideration within the intent of the Commerce Clause. Therefore, the AAA-CPA respectfully requests that this Court affirm the judgment of the Supreme Court

[34] Streamlined Sales Tax Governing Board, Inc., *How many states have passed legislation conforming to the Agreement?* http://www.streamlinedsalestax.org/index.php?page=gen6.

[35] *Leisy*, 135 U.S. at 108-09.

of South Dakota by upholding *Quill* and the bright-line physical presence test.

Respectfully submitted,

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