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CSOLNIK@LIBN.COM 631.913.4244 @CLAUDESOLNIK

Tempest in the tax code

Supreme Court ruling revolutionizes sales tax

By CLAUDE SOLNIK

The United States Supreme Court's decision that allows states to assess sales tax on inter-state transactions will most directly impact e-commerce, but could reach far beyond the Internet and lead to extensive obligations and compliance issues.

The court in South Dakota v. Wayfair ruled South Dakota could impose sales tax on transactions involving state residents on vendors with at least $100,000 in revenue or 200 transactions with South Dakota residents, even if the vendor doesn't have a physical presence in its state.

South Dakota, which has no income tax, argued that the "nexus" was enough if the customer was present in a state, even if the retailer itself is not.

The 5-4 decision overturns the physical presence standard which the Supreme Court adopted 26 years ago in Quill v. North Dakota and opens the door to obligations to collect sales tax to which Internet firms had long been immune.

Justice Anthony Kennedy, writing on behalf of the majority including Justices Alito, Gorsuch, Ginsburg and Thomas, said as Internet sales become widespread, the "physical presence rule becomes further removed from economic reality."

He said that the Quill decision had become outdated and "imposes the sort of arbitrary, formalistic, distinction that the court's modern commerce clause precedents disavow."

"Today's Supreme Court decision in *South Dakota v. Wayfair* could turn out to be almost as significant for American businesses as the recent rewrite of the U.S. federal tax code," Jeffrey LeSage, Americas vice chairman in charge of tax, at KPMG, with Long Island offices in Melville, said. "It's a decision that reflects the realities of an increasingly digital global economy."

Although brick-and-mortar retailers often have online sales, some said forcing online firms to charge sales tax would help flatten the tax code by removing that tax advantage from the Web.

"This is a huge win for the brick and mortar retail industry, particularly on Long Island.," Kyle Strober, executive director of the Association for a Better Long Island, said. "This will level the playing field for mom and pop shops so customers on Long Island rather than going to specialty sites will consider going to their local retailer."

He added that by boosting brick-and-mortar retailers, the ruling could be good news for the real estate industry as well.

"Good tenants make landlords happy. Tenants that thrive will be beneficial to landlords," Strober said. "This could be another way to generate revenue for the local municipalities, to keep property taxes down."

Government officials often said this will boost local businesses, which have long had to compete with online sellers who didn't charge sales tax.

"The ruling today by the Supreme Court has put the ability to collect sales tax from Internet sales in the hands of the state," Nassau County Executive Laura Curran said, "and gives a tremendous boost of confidence to local businesses that struggle to compete with internet commerce."

Suffolk County Executive Steve Bellone called the decision "a major victory for small businesses and county governments across the country."

Online sellers, he said, would be subject "to the same tax collection requirements as our brick and mortar stores," although they could be forced to comply with far more tax levies. "Healthy competition only works when everyone is playing by the same rules," Bellone said.

The new tax rules, however, will expose even small companies to sales tax obligations in numerous jurisdictions, which could lead to information technology, compliance and other costs.

Photo by Judy Walker

KYLE STROBER: The U.S. Supreme Court decision regarding sales tax is a big win for brick-and-mortar retailers.

Photo courtesy of EisnerAmper

GARY BINGEL: States come out ahead in the new ruling, while businesses with sales across state lines face new obligations.

"The Supreme Court decision changes the landscape on a national level," Anthony Capone, tax director at KPMG, added. "There's no question it's going to be painful for small business owners operating in multiple states."

Even though the most obvious impact is on online sales and government, accountants said the decision could ripple far beyond that, revolutionizing retail.

Large online marketplaces such as Amazon, for instance, often already collect sales tax on direct sales, but many states passed rules requiring marketplace sellers to collect on behalf of others who use its platform. Etsy and Ebay, among others, could be impacted.

"The winners are certainly the states. The losers are businesses that do sales across state lines, multi-state businesses," said Gary Bingel, partner in charge of state and local taxes at EisnerAmper, with Long Island operations in Syosset. "E commerce is the most common interstate sale, but it applies to more than that."

Nearly 20 other states already have similar rules, but Bingel said other states, such as New York are likely to join in.

New York, which already has rules related to income tax, is expected to impose its own variation on the South Dakota ruling, generating cash for the state.

"They have not come out with their interpretation of what they're going to do with this decision," Bingel said. "My gut decision is they'll enact something in fairly short order."

Some, however, argue that abandoning the test for a company's physical presence opens the floodgates to taxes, which will cost consumers more and unleash a new torrent of taxes.

"The decision leaves e-commerce and especially small sellers extremely vulnerable to states gluttonous for tax revenue, particularly from consumers and businesses with no representation in their state," Tom Giovanetti, president of Dallas-based Institute for Policy Innovation, said. "If that sounds to you like taxation without representation, you're right."

In addition to e-commerce, catalogues and even those providing services out of state such as lawyers accounting firms and others could be impacted in some states.

"It could affect anybody doing business across state lines potentially," Bingel said. "Many of the laws written for sales tax say sales of goods or services. It could also impact law firms. A handful of states impose sales tax on legal services. Some states impose sales tax on accounting outsourcing."

Many companies are going to face new costs, which could alter the bottom line of doing business on the Internet beyond simply the added cost of paying tax.

"Their cost of business is going to increase dramatically," Capone said of firms with out-of-state sales. "Those companies will have to look at their technology needs. It's going to require them to register in states where they're not and file tax returns."

Complying could be complicated and costly, due to the number of sales tax jurisdictions nationwide, which could impact even relatively small firms with sales to many regions.

Bingel said the ruling could impact between 10,000 and 12,000 taxing jurisdictions nationwide, far beyond simply fifty for 50 states. In Louisiana and Colorado, for instance, various parishes impose their own sales tax.

"I've got companies that are $300 million or $400 million in sales that have to revamp their systems. They lacked physical presence in some states and will have to collect and file," Bingel said. "They now have to buy rates packages. Then you have to file returns, which is an additional cost. And there's the cost of audit defense when the states start auditing you. It is much more difficult than income tax in many ways, because of the nuances and administrative burdens the states put on."

Tax rate software, integrating this system with accounting, generating and filing returns all could add up, especially for small firms.

"They're going to have to raise their prices to keep up with the cost of complying and filing," Bingel said. "It's a big expense. You could put some businesses out of business."

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