

**NetChoice** Promoting Convenience, Choice, and Commerce on The Net

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August 26, 2018

W. Hartley Powell, Director  
South Carolina Department of Revenue  
Attn: Director  
P.O. Box 125  
Columbia, South Carolina 29214-0505

**RE: Comments Regarding SC REVENUE RULING #18- x [DRAFT - 8/10/18 – “DOC. 1”]**

Dear Director Powell:

We write with concerns regarding the approach outlined in SC REVENUE RULING #18- x [DRAFT - 8/10/18 – “DOC. 1].” We note that such an approach would violate the commerce clause of the US Constitution, the Internet Tax Freedom Act,<sup>1</sup> and represents a misreading of the US Supreme Court decision in *South Dakota v Wayfair*.<sup>2</sup>

We urge the Department of Revenue to abandon this approach.

**Failure to provide a reasonable time for marketplaces and sellers to implement constitutes an undue and unreasonable burden on interstate commerce**

Many tax service providers who are certified by the Streamlined Sales Tax Project are now informing sellers that software implementation could take as much as a year. Moreover, many of these Certified Service Providers (CSPs) are working against a significant backlog due to a surge in demand. This results in a very low likelihood that sellers and marketplaces can begin to collect sales taxes for South Carolina by the planned implementation date of October 1, 2018.

In addition, the cost of implementing tax collection solutions can run into hundreds of thousands of dollars – even for small businesses. The True Simplification of Taxation (TruST) coalition commissioned a study to measure the upfront and ongoing costs, examining both catalog and online retailers in the mid-market bracket (\$5 - \$50 million in annual sales).<sup>3</sup> The study found that mid-market online retailers

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<sup>1</sup> 47 U.S.C. § 151.

<sup>2</sup> *South Dakota v. Wayfair, Inc.*, 585 U.S. \_\_\_\_ (2018).

<sup>3</sup> Larry Kavanagh and Al Bessin, *The Real-World Challenges in Collecting Multi-State Sales Tax*, September 2013.

would have to spend \$80,000 to \$290,000 in setup and integration costs in order to use the so-called “free” software promised by the Streamlined Sales Tax Project.

And unlike South Dakota, South Carolina lacks any vendor compensation for remote seller businesses seeking to comply with these new obligations.

Such burdens would be an undue burden on interstate commerce and a likely violation of the commerce clause of the US Constitution.

### **Sales tax liability cannot be imposed on marketplaces, since they are not the seller of record**

A marketplace is not the seller of record for any orders it accepts on behalf of the actual seller. The Department lacks the basis on which to assign this liability, whether for sales tax collection or otherwise.

The Department incorrectly analogizes marketplaces to consignment stores to justify its legal authority.<sup>4</sup> Unlike a consignment store, which warehouses goods for sale, marketplaces do not house, or even touch, the goods being sold. Take for example Etsy and eBay, where sellers ship directly to marketplace customers. And unlike a consignment shop, there is no requirement that the marketplace process the payments.

A better analogy to online marketplaces would be a shopping mall. Online marketplaces provide sellers a place to reach customers and conduct business. Sellers can create their own stores on marketplaces just like they would in a shopping mall. It would be absurd to hold the Coastal Grand Mall in Myrtle Beach liable for sales tax collection of stores in the mall. Yet the Department’s approach would impose that kind of liability on online marketplaces.

### **The new tax would violate Interstate Commerce Protections in the US Constitution.**

To suggest that the Supreme Court’s decision in *South Dakota v Wayfair* makes constitutional this new tax on marketplaces is a misreading of the court’s decision. The Department shows its misunderstanding of the Supreme Court when it said:

As a result of the *Wayfair* decision, the determination as to when an online marketplace *must begin remitting the sales and use tax* on retail sales into South Carolina depends on whether the online marketplace has physical nexus or economic nexus with South Carolina.<sup>5</sup>

First, the Supreme Court decision in *South Dakota v Wayfair* did not find that the South Dakota law was constitutional. The court merely found that the physical presence rule of *North Dakota v Quill* is no

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<sup>4</sup> “The online marketplace is the same as any other retailer selling another person’s product, such as a consignment store or an auction house...The person who places his items *in the consignment* store to be sold by the store is not the retailer and is not liable for the sales and use tax on sales made through the consignment store.” SC REVENUE RULING #18- x [DRAFT - 8/10/18 – “DOC. 1”] (Aug. 27, 2018) (emphasis added).

<sup>5</sup> SC REVENUE RULING #18- x [DRAFT - 8/10/18 – “DOC. 1”] (Aug. 27, 2018) (emphasis added).

longer good law. This means that South Dakota’s law might still be held as unconstitutional under the three other prongs of the *Complete Auto*<sup>6</sup> test.

Nor did the court rule on whether South Dakota’s law could survive a challenge of violating the Federal Internet Tax Freedom Act (ITFA) discussed below.

And, the Supreme Court’s decision in *Wayfair* said nothing about imposing tax collection obligations on marketplaces. The South Dakota law imposes tax liability on actual sellers of record and not upon marketplaces. So, to assert that the Department’s tax collection approach is constitutional is a misread of the decision and of dicta in *Wayfair*.

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*South Carolina fails to meet any of the factors suggested by the Supreme Court.*

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Finally, South Carolina fails to achieve all of the factors suggested by the Supreme Court in *Wayfair*. Unlike South Dakota, South Carolina has not adopted the Streamlined Sales and Use Tax Agreement (SSUTA), has inadequate small seller protections,<sup>7</sup> and expressly allows retroactive taxation back to 2016.<sup>8</sup>

#### **The retroactive tax language must make clear that *no back taxes are owed***

One of the points made by Justice Kennedy’s dicta in *Wayfair* was the importance of eliminating retroactivity to achieve constitutionality under *Complete Auto*.

However, the language in the Department’s notice expressly allows for these back taxes while eliminating retroactivity for new taxes *created* by this regulation. This would still expose thousands of small businesses to retroactive liability for other sales tax obligations not addressed by this ruling.

#### **The Department’s rule is unconstitutional as a violation of the federal Internet Tax Freedom Act**

In 2016, a Republican-controlled congress and a Democratic president made permanent the Federal Internet Tax Freedom Act (ITFA). The ITFA prohibits states from imposing “any tax . . . on electronic commerce that is not generally imposed and legally collectible by such State.”<sup>9</sup> In addition, part of the legislative purpose of the ITFA was to prevent the same type of Internet e-commerce discrimination that the New Tax seeks to create.

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<sup>6</sup> *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)

<sup>7</sup> Adjusted for GDP, South Carolina’s small seller threshold should be \$434,000 or 868 transactions.

<sup>8</sup> “These online marketplaces must obtain a retail license from the Department that is effective the first day physical nexus is established. Note: An online marketplace with a distribution facility in South Carolina established and meeting the requirements of Code Section 12-36-2691 is not considered to have established physical nexus with South Carolina until January 1, 2016.” SC REVENUE RULING #18- x [DRAFT - 8/10/18 – “DOC. 1”] (Aug. 27, 2018).

<sup>9</sup> 47 U.S.C. § 151.

In a court filing in Massachusetts, former Congressman Chris Cox,<sup>10</sup> an author of ITFA said,

There can be no question the ITFA is meant to apply to taxes on the e-commerce transactions that are the subject of Massachusetts Directive 17-1.

...

Directive 17-1 plainly violates the ITFA's prohibition on discriminatory taxes. Under Directive 17-1, out-of-state catalog and mail order vendors will not be required to collect Massachusetts sales or use taxes - but out-of-state Internet vendors will. This is the quintessence of the discrimination against Internet commerce that ITFA was written to prevent.

...

By specifying uniquely Internet-related factors as the very criteria upon which the Massachusetts sales and use tax collection and reporting obligations are based, Directive 17-1 has made itself a prime example of what the ITFA was meant to prohibit. Its enunciation of aspects unique to Internet commerce such as cookies, apps, CDNs, and online marketplaces offends the plain terms of the ITFA.

Soon after Massachusetts issued its own “cookie nexus” directive,<sup>11</sup> NetChoice and the ACMA sued for injunction and the Massachusetts Superior Court quickly invalidated the regulation.<sup>12</sup>

The Department’s proposed rule unfairly discriminates against online sales and would be a clear violation of the ITFA, resulting in a likely challenge and injunction.

We appreciate your consideration of our views, and please let us know if we can provide further information.

Sincerely,

Carl Szabo  
Vice President and General Counsel  
NetChoice

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<sup>10</sup> See. *Am. Catalog Mailers Ass’n & NetChoice v. Heffernan*, No. 2017-1772 BLS1 (Mass Supp. Ct. June 28, 2017).

<sup>11</sup> Mass. Dept. of Rev. Directive 17-1

<sup>12</sup> See. *Am. Catalog Mailers Ass’n & NetChoice v. Heffernan*, No. 2017-1772 BLS1 (Mass Supp. Ct. June 28, 2017).