Two Cheers For Sales Tax Reform

The prayers of brick-and-mortar retailers may finally be answered if the U.S. Supreme Court strikes down the 1994 North Dakota vs. Quill judgement that made it possible for most mail order retailers to skirt collecting sales tax. This quirk in the tax law unquestionably tilted the scales in favor of online sellers for close to three decades. As brick-and-mortar music retailers regularly complain, "Even if we match their price, we're still charging the customer between 5 and 9% more because of the sales tax." However, any decision addressing cross-border sales tax collection may bring with it an entirely new set of unwelcome problems, so it's prudent to hold off on the celebration.

First, a little background on how we got where we are, and what might lie ahead. In 1992 the State of North Dakota sued Quill, a Minneapolis-based seller of office products, demanding unpaid sales tax. Attorneys argued that the thousands of catalogs Quill mailed into North Dakota constituted an "in-state presence," and thus the retailer was responsible for collecting and remitting sales tax. Quill's legal team dissented vigorously, all the way up to the Supreme Court. Justice John Paul Stevens ultimately ruled in favor of Quill. Citing the Constitution's Commerce Clause, he argued that to be liable for sales tax, a business had to have a physical presence in the state that included some combination of personnel and facilities. Catalogs apparently didn't count. In his ruling, though, Stevens left the door open for Congress to draft legislation that would either redefine what constituted a physical presence or enable some type of cross-border tax collection. Twenty-four years later, no meaningful legislation addressing the issue has been produced, although numerous states, including New Jersey, New York, and Connecticut, have established reciprocal sales tax collection agreements.

On April 17, the Supreme Court heard oral arguments for the case of South Dakota vs. Wayfair, which is very similar to the 1992 Quill case. South Dakota contends that the numerous independent merchants who use the Wayfair digital marketplace to sell housewares owe an estimated $50 million in unpaid sales taxes. At issue is whether the Wayfair website and app, which reside on computers and tablets throughout the Mount Rushmore State, constitute an "in-state" presence. Supreme Court justices try not to telegraph their judicial leanings in advance, but court watchers are predicting a ruling sometime in July that favors South Dakota.

Such a ruling would enable states to reach across borders to levy sales tax bills on remote online sellers, thus creating an entirely new set of challenges. Would revenue hungry states launch sweeping nationwide efforts to collect taxes from out--f state merchants? Would they be emboldened to use harsh methods, knowing that their distant targets would not have any recourse in the voting booth? What would a reasonable threshold be for incurring a sales tax liability? $10 in sales? $10 million? What about the case of a music dealer with a brick-and-mortar store generating 35% of its revenue on eBay and Reverb? What would that dealer's reaction be when ten states sent bills for unpaid sales taxes, along with additional fines and penalties? What is the administrative cost to calculate and remit appropriate sales tax to the thousands of distinct jurisdictions nationwide, and is there any accessible software that can help?

While waiting for answers to these and numerous other questions, we'd suggest that any court ruling may not significantly alter the competitive balance between brick-and-mortar and online sellers. For starters, avoiding sales tax is just one reason customers shop online; it's certainly not the only reason. Furthermore, with the exception of a handful of high-end piano retailers, every store in our annual Top 200 ranking is an online seller to one extent or another. They either sell through their own sites, or on the various online marketplaces. Consequently, if the Supreme court decided toe "level the playing field," they could face potential tax compliance issues. Ironically, the court's decision will have no impact on "mega-retailers." Amazon, Wal-Mart, Target, and numerous others are already collecting and remitting sales tax nationwide. The burden will fall disproportionately on small businesses, which includes the vast majority of music retailers.

Retail is retail whether it's done over the counter or on a website. Since basic fairness dictates according similar legal treatment to similar activities, it follows that if brick-and-mortar retailers are responsible for collecting sales tax, so should their online competitors. Unassailable logically, but how it plays out once state taxing agencies get involved is anyone's guess. Will brick-and-mortar retailers regain a competitive edge with the playing field "leveled?" Or, will they face unforeseen liabilities and extra administrative cost complying with out-of-state agencies? Let's hope for the former, but prepare for the latter.

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