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Tax obligations for online retail sales not so easy to avoid anymore

THE BUZZ

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Historically, if an out-of-state retailer lacked physical presence in a particular state, the retailer was under no obligation to report sales. Earlier this year, however, the U.S. Supreme Court granted South Dakota the authority to impose sales tax obligations on out-of-state retailers, or remote retailers, with no physical presence there.

The landmark decision in *South Dakota v. Wayfair Inc.*, No. 17-494 (June 21), circumvented nexus standards that have been in place for the last 50 years. Many states, including Illinois, have passed legislation to address out-of-state retailers' tax obligations.

Physical nexus

Prior to Oct. 1, the Illinois Use Tax Act required a remote retailer making sales to Illinois residents to register with the Illinois Department of Revenue if the remote retailer maintained a physical presence in the state. A physical presence "nexus" has been found to include one of the following:

• Maintaining an office, warehouse or place of business in Illinois.

• An agent salesperson or representative operating in Illinois.

• Maintaining a referral or distributor arrangement with an Illinois person or entity of which the cumulative gross sales of the remote retailer as a direct result of the Illinois contact equals $10,000 or more a year.

• Targeted solicitations to Illinois consumers that are calculated to incite a person to purchase items from the specific remote retailer.

Christina Mermigas, an attorney with my firm, Chuhak & Tecson P.C., said, "When a remote retailer lacked physical presence in Illinois, the reporting requirement fell on the Illinois customer, who was required to report and pay use taxes on the items purchased from remote retailers on their individual tax return."

However, this self-reporting mechanism lacked oversight from the Revenue Department and was rarely followed by Illinois residents. As a result, consumers were still receiving products from the remote retailer while the state was losing tax revenue it would otherwise have gained if the remote retailer had a physical presence or minimum contacts in Illinois.

Move to economic nexus

In *Wayfair Inc.*, the Supreme Court sidestepped the physical nexus requirement. Mermigas said, "Now, an economic nexus is sufficient to require a remote retailer to register with the IDOR for a sales tax permit, to collect and remit the 6.25 percent sales tax on sales to Illinois residents."

The court accomplished this by altering the definition of "retailer maintaining a place of business" and "serviceman maintaining a place of business" as provided by the Illinois Use Tax Act.

As a result, retailers and servicemen will now be said to have an economic nexus with Illinois if they have either $100,000 or more cumulative gross receipts from Illinois sales in one year; or 200 or more separate transactions, indicated by separate invoices regardless of when the item actually shipped, with Illinois customers in one year.

Thus, if a Wisconsin remote retailer sells its baby products through its website or Etsy to Illinois residents and meets either of the two economic nexus thresholds, the Wisconsin retailer will have an economic nexus with Illinois and must collect and remit Illinois sales tax regardless of its de minimis contacts within Illinois.

What does this mean for remote retailers?

Effective Oct. 1, remote retailers will need to focus on their economics from sales and frequency of transactions in all 50 states to determine if they have economic nexus with one or more states in the nation. In Illinois, remote retailers face an additional burden of making quarterly assessments as to whether or not they have an economic nexus during the preceding 12-month period. If so, the remote retailer will need to collect, remit tax and file tax returns for the subsequent year.

One could see the potential burden that nationwide sales tax collection will have on small businesses that sell small volumes of products to many states.

In the wake of *Wayfair*, most states passed legislation imposing monetary or numerical thresholds similar to that of Illinois' to create economic nexus. The result: Remote retailers now must carefully navigate crushing tax rates and complicated registration requirements in every state in which it sells its products to avoid tax violations.

The impact

Mermigas cautions that this new requirement raises the question of whether or not its intricacies reflect the growing shift toward online and electronic consumerism at the expense of brick-and-mortar stores or if this nexus requirement is overreaching.

This standard affects every business making taxable sales in more than one state, which, considering the ease of conducting sales via the internet, means every operating business in the nation.

Most major online retailers such as Amazon have already moved to collect sales tax in recent years. While it is hard to predict the economic impact this new requirement will have on mom-and-pop shops, one could see the potential burden that nationwide sales tax collection will have on small businesses that sell small volumes of products to many states.

Another consideration is the effect that this additional tax revenue will have on the Illinois deficit.

Prior to this modification, remote retailers with no physical nexus to Illinois had no tax consequences as a result of their sales to Illinois customers, instead relying on the customers' use tax obligations to disclose such transactions to the Revenue Department.

Because many people were unaware of this reporting requirement and because such reporting was viewed as "voluntary," people failed to report their purchases, thereby costing states millions of dollars in lost revenue.

Mermigas said, "While this economic nexus standard comes with predictions instead of guarantees, putting remote retailers on the hook for tax obligations (rather than individual purchasers) could increase state tax revenue.

"Only time will determine whether this increased revenue for the state comes at the cost of an increased rate of closure of small businesses."