

Arizona Is Not Prepared to Implement the *Wayfair* Decision

by James G. Busby Jr.

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In this edition of SALT From My Saddle, Busby highlights some of the obstacles that will likely prevent Arizona tax collectors from lawfully collecting tax from remote sellers until the state Legislature updates and simplifies its tax system to be more like South Dakota's.

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In *South Dakota v. Wayfair Inc.*,¹ the U.S. Supreme Court rejected the *Quill*² physical presence requirement and determined that South Dakota's economic nexus statute, which requires \$100,000 in annual sales to in-state customers or 200 annual transactions with South Dakota customers, satisfies the substantial nexus prong of the four-part *Complete Auto*³ test used to gauge whether state taxes that apply to transactions in interstate commerce are permissible under the commerce clause.

¹585 U.S. ___ (2018).

²*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

³*Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977).

Critical Aspects of South Dakota's Tax System

After killing *Quill*, the Court remanded the *Wayfair* case to the South Dakota Supreme Court to ensure that the state's law does not otherwise discriminate against or impose undue burdens on interstate commerce — like by violating another prong of the *Complete Auto* test, for example.

When doing so, the *Wayfair* opinion highlighted three key features of South Dakota's tax system that it said "appear designed to prevent discrimination against or undue burdens upon interstate commerce." First, it has a safe harbor for those who only conduct limited business in the state. Second, affected business have no retroactive obligation to remit taxes. Third, South Dakota adopted the Streamlined Sales and Use Tax Agreement. These critical features of South Dakota's tax system are conspicuously absent from Arizona's.

Arizona Does Not Have an Economic Nexus Statute

Arizona does not have a statute like South Dakota's that imposes a tax collection obligation on remote vendors that have at least \$100,000 in sales to customers in the state or engage in at least 200 transactions with customers in the state annually. If Arizona wants to begin collecting tax from remote vendors, its Legislature should first enact an economic nexus standard that, like the South Dakota law upheld in *Wayfair*, is not retroactive.

Arizona's Taxing Statutes Are Anything but Streamlined

The *Wayfair* opinion emphasized some SSUTA features that South Dakota adopted to reduce administrative burdens and compliance costs for taxpayers, including state-level tax administration, uniform definitions of products

and services, simplified tax rate structures, uniform rules, and tax administration software provided by the state, the use of which immunizes sellers from audit liability.

Arizona has not adopted the SSUTA or any of its features that were designed to reduce administrative and compliance costs for taxpayers. Worse yet, Arizona permits its municipalities to select from over 50 tax base options, which results in many tax base differences between the 91 Arizona municipalities that impose sales taxes in addition to differences between each municipality and the state.

Perhaps the Council On State Taxation's April 2018 Scorecard on State Sales and Use Tax Administration best summarized the difference between South Dakota's sales tax system and Arizona's sales tax system when it awarded South Dakota an "A" and assigned Arizona a "D" on simplicity and transparency grounds.⁴

Arizona Municipalities Have Their Own Tax Codes

In addition to Arizona not having adopted the SSUTA and allowing its municipalities to select from over 50 tax base options, the state permits each of its municipalities to levy taxes under their own separate tax code.⁵ This alone makes Arizona's tax system one of the most burdensome, difficult, and expensive among the states for taxpayers to comply with.

A Tax-Neutral Solution

If Arizona wants to collect its share of taxes from remote sellers — recently estimated at \$190 million to \$293 million annually⁶ — its Legislature will have to implement significant tax code changes. However, Arizona's Republican-

dominated Legislature and Gov. Doug Ducey (R) are unlikely to enact legislation to raise taxes.

If they want to level the playing field between local and remote vendors without raising taxes, they may want to follow the lead of Wisconsin's Republican Gov. Scott Walker. Walker suggested that his state should begin collecting sales taxes on internet purchases but offset the tax increase with tax cuts of the same amount elsewhere. "It shouldn't be a tax increase. It should be leveling the playing field for retailers and other operations in the state," Walker told reporters.⁷

If Arizona chooses to level the playing field between local and remote vendors, that would be the perfect time to enact other important tax code changes that opponents have argued would cost the state too much money. For instance, the Legislature could specify which digital goods and services it wants to tax going forward, but at the same time acknowledge that digital goods and services were not subject to tax in the past.⁸ Likewise, the state could dramatically simplify the way it taxes construction contractors by collecting taxes on building materials, like most other states do.⁹ After implementing these changes, if the state is still collecting more money on a net basis, one or more automatic triggers could kick in to reduce tax rates for all taxpayers. ■

⁴ Karl Frieden and Fred Nicely, "The Best and Worst of Sales Tax Administration," COST, Apr. 2018.

⁵ As explained in a previous edition of this column, even if Arizona adopts an acceptable statutory economic nexus standard and simplifies its tax code so it can begin collecting taxes from remote sellers going forward, if Arizona municipalities levy taxes under their own separate tax codes, they may not be able to force remote sellers to collect and report taxes to them. See James G. Busby Jr., "Wayfair May Have a Minimal Effect on Municipal Nexus in Arizona," *State Tax Notes*, May 21, 2018, p. 803.

⁶ United States Government Accountability Office Report to Congressional Requesters, GAO-18-114, at 48 (Nov. 2017).

⁷ Patrick Marley, "Gov. Scott Walker: Wisconsin Will Collect Online Sales Taxes and Then Cut Other Taxes by Same Amount," *Milwaukee Journal Sentinel*, June 25, 2018.

⁸ See Busby, "Arizona Left Providers of Digital Goods and Services in a Pickle," *State Tax Notes*, June 4, 2018, p. 1003.

⁹ See Busby, "Taxing Contractors Under Arizona's Sales Tax Reform Laws," *State Tax Notes*, June 1, 2015, p. 673.