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In this installment of SALT From My Saddle, Busby, in consultation with Professor Richard D. Pomp, explains how H.B. 2757, Arizona's response to *Wayfair*, will actually compound the state's burden on remote sellers even though it also will dramatically simplify the state's overall sales tax structure.

In previous columns I explained that:

> Arizona's Legislature recently amended the state's tax code to require remote sellers to remit sales tax on proceeds from sales to customers in the state based on economic nexus standards, adopted marketplace facilitator provisions, and preempted cities and towns from imposing retail sales taxes under their own tax codes.[1]

I further wrote that:

> Preempting cities and towns from imposing retail sales taxes under their own tax codes will dramatically simplify Arizona's sales tax structure under which 91 cities and towns currently impose retail sales taxes under their own tax codes but, even after these changes go into effect,[2] there still will be numerous differences between the state tax base and the tax bases for various cities and towns in Arizona.[3]

Ironically, even though H.B. 2757 will preempt Arizona cities and towns from imposing retail taxes under their own tax codes and thus dramatically simplify the state's overall sales tax structure for retailers by eliminating all 91 municipal retail tax codes, the bill will simultaneously compound the burden the state imposes on remote sellers.

Arizona's Burdensome Sourcing Rules

Arizona's burdensome sourcing rules are not new, but because the state's response to *Wayfair* will require so many more remote sellers to comply with them, H.B. 2757 will compound the burdens the state imposes on remote sellers.

As Richard D. Pomp[4] cautioned in a letter to the sponsor of H.B. 2757, Rep. Ben Toma (R), the bill did not address a "troubling and

[1] *See* James G. Busby Jr., "Arizona's Response to *Wayfair* Eliminates Municipal Retail Tax Codes," *Tax Notes State*, June 24, 2019, p. 1151.

[2] Most of the changes go into effect on October 1, 2019.

[3] *See* Busby, "Arizona's *Wayfair* Law Perpetuates Some State/City Differences," *Tax Notes State*, July 1, 2019, p. 27.

[4] Richard D. Pomp, the Alva P. Loiselle Professor of Law at the University of Connecticut Law School and adjunct Professor of Law at the NYU Law School in the LLM Program in Taxation, has studied, lectured, taught, published, consulted, and testified on issues of state taxation for more than 40 years.

constitutionally suspect provision of the Arizona transaction privilege tax."[5] Pomp referred to the state's sourcing rules for remote vendors, which differ from the state's sourcing rules for in-state vendors.

In Arizona, "sales by in-state retailers are sourced to the *seller's business location* if the seller receives the order at a business location in the state, regardless of where the purchase is shipped. By comparison, sales by out-of-state vendors are sourced to the *purchaser's location* in this state if the seller receives the order at a business location outside this state, regardless of where that person resides," Pomp explained.[6]

In his letter, Pomp posed a hypothetical in which "a resident of local Jurisdiction X shops at a store in local Jurisdiction Y and has the purchase shipped back to X. The local sales tax will be based on rates in Y. In contrast, if that same person were to order online, the remote vendor would charge tax based on rates in X, which could be higher than the Y rates." Citing the U.S. Supreme Court's decision in *Associated Industries v. Lohman*,[7] Pomp warned that this type of "discrimination against interstate commerce has been held to be unconstitutional."[8]

In addition, Pomp warned that "such discrimination would violate the Internet Tax Freedom Act,"[9] in particular section 1105(2), a provision that defines a "discriminatory tax" as "any tax imposed by a State or political subdivision thereof on electronic commerce that . . . is not generally imposed and legally collectible at the same rate by such State or political subdivision on transactions involving similar property, goods, services."[10] Pomp further cited the Illinois Supreme Court decision in *Performance Marketing Association v. Hamer*.[11]

To illustrate his point, Pomp shared an example using actual tax rates to demonstrate how dramatically Arizona's sourcing rules can discriminate against remote vendors. He wrote:

> Suppose a resident of Superior shops at a store in an unincorporated area of Pima County and has the purchase shipped back to his or her home in Superior. The in-state retailer would pay tax based on the total state and local rates that apply in unincorporated areas of Pima County: 6.1%. By comparison, if that same person were to order over the Internet from an out-of-state vendor, the remote vendor would have to pay tax based on the total state and local rates in effect in Superior, 11.2% — a much higher rate than the rate the local vendor was required to pay.[12]

Finally, Pomp noted that unlike local vendors who only have to apply the combined tax rate in effect at the location where they receive orders, remote vendors have to "apply up to 91 different municipal tax rates, and as many as 15 different county rates."[13] Pomp concluded, "these are all serious defects in the existing law" that were not addressed by Arizona's response to *Wayfair*.[14]

Other Burdens on Remote Sales Into Arizona

In addition to retaining its burdensome sourcing rules, Arizona has not simplified its sales tax structure in other key ways that may also make it difficult for the state to defend its new economic nexus thresholds against a constitutional challenge.

While *Wayfair* did not hold that states must adopt the Streamlined Sales and Use Tax Agreement to implement economic nexus standards, it explained that the SSUTA is important because it:

- "standardizes taxes to reduce administrative and compliance costs";

[5] *See* letter from Richard D. Pomp to Rep. Ben Toma (Mar. 29, 2019). Pomp's letter addressed the constitutional implications of H.B. 2702, the first bill Toma sponsored to address *Wayfair*. Notably, H.B. 2702 did not include the provisions in H.B. 2757 that preempt Arizona cities and towns from imposing retail taxes under their own tax codes. Those provisions were not added until the author of this column and one of his colleagues met with Toma and House Speaker Russell Bowers (R) to discuss their concern that H.B. 2702's economic nexus provisions probably would not survive a constitutional challenge unless the state dramatically simplified its sales tax system.

[6] *Id*. (emphasis in original), citing Ariz. Rev. Stat. section 42-5040.

[7] 511 U.S. 641 (1994).

[8] *See* Pomp, *supra* note 5.

[9] *Id*.

[10] P.L. No. 105-277, Title XI, 112 Stat. 2681, 2719 (1998) (codified as amended at 47 U.S.C. section 151).

[11] 998 N.E.2d 54 (Ill. 2013).

[12] *See* Pomp, *supra* note 5.

[13] *Id*.

[14] *Id*.

- "requires a single, state level tax administration";
- "requires . . . uniform definitions of products and services";
- "requires . . . simplified tax rate structures";
- "requires . . . other uniform rules"; and
- "provides sellers access to sales tax administration software paid for by the State" and "sellers who choose to use such software are immune from audit liability."[15]

South Dakota adopted the SSUTA to simplify its sales tax system in all six of these key ways emphasized by the Court.

Simplifying the state's sales tax structure by moving to a single statewide retail sales tax base probably was the most important thing Arizona could have done to prepare itself to defend its new economic nexus thresholds against a constitutional challenge. But as explained below, because the state still has not implemented most of the key simplifications *Wayfair* emphasized, it may not be able to successfully defend its economic nexus rules.

Comparing Arizona's sales tax structure with South Dakota's sales tax structure — the latter is the only sales tax structure to date that includes economic nexus thresholds that have withstood scrutiny by the Supreme Court — demonstrates that Arizona has not done nearly as much as South Dakota to simplify its sales tax system. This is seen by contrasting Arizona's sales tax structure with the Court's observations about South Dakota's structure and the SSUTA.

First, the SSUTA "standardizes taxes to reduce administrative and compliance costs." By moving to a single statewide retail sales tax base, Arizona is dramatically simplifying its sales tax structure. However, Arizona's sales tax system still will be different from the sales tax systems in effect in the 23 SSUTA states. Because Arizona imposes a transaction privilege tax rather than a true sales tax, it is unique among the 45 states that impose some form of a sales tax. In that respect, Arizona has not standardized its taxes compared with other states.

Second, the SSUTA "requires a single, state level tax administration." To its credit, by early 2017 the Arizona Department of Revenue was issuing all local sales tax licenses, overseeing all sales tax audits, and processing all sales tax returns. At this point, Arizona seems to be on solid ground on this issue.

Third, the SSUTA "requires . . . uniform definitions of products and services." As explained above, by moving to a single statewide retail sales tax base, Arizona is dramatically simplifying its sales tax structure, but its definitions still will be different from the definitions in effect in the 23 states that have adopted the SSUTA. In that respect, Arizona's definitions still will not be uniform.

Fourth, the SSUTA "requires . . . simplified tax rate structures." As explained in the previous section, this probably is the most significant of the obstacles that remain for the state to address to survive remote-vendor constitutional challenges. And the tiered rates in many Arizona cities and towns, where purchases up to a certain amount are taxed at one rate while the remainder of the same transaction is taxed at a different rate, won't help the state's cause if it is forced to defend its system. If the state wants its economic nexus thresholds upheld, it should act quickly to simplify its sourcing and tax rate structures.

Fifth, the SSUTA "requires . . . other uniform rules." Once again, by moving to a single statewide retail sales tax base, Arizona is dramatically simplifying its sales tax structure, but its rules still will be different from the rules in the 23 SSUTA states. In that respect, Arizona's rules still will not be uniform.

Finally, the SSUTA "provides sellers access to sales tax administration software paid for by the State" and "sellers who choose to use such software are immune from audit liability." Arizona does not provide sellers with access to free sales tax administration software or with immunity from audit liability for using such software. If Arizona is not going to adopt SSUTA — which would resolve the first, third, and fifth points above — it should seriously consider offering free software to retailers to help them navigate the state's unique sales tax system and providing immunity from audit liabilities to retailers that rely on it. If the software accounts for the Arizona municipalities' complicated tiered-

[15] *South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080, 2100 (2018).

rate structures, it may help mitigate the fourth point as well.

Potential Remedial Actions

As was the case in many other states, rather than take time to study how they could best position the state to implement — and overcome any challenges to — economic nexus provisions following *Wayfair*,[16] Arizona lawmakers acted quickly in hopes of collecting additional revenues from remote vendors as soon as possible.

Because none of the economic nexus statutes enacted in other states have been adjudicated by a court, nobody knows whether a state that has not adopted the SSUTA or otherwise simplified its tax system in all six of the ways *Wayfair* emphasized will be able to successfully defend its economic nexus statute. However, states that replicate or virtually replicate South Dakota's sales tax structure in all material respects will be best positioned should a challenge arise. Arizona lawmakers should consider either revising the state's sourcing rules so sales by remote sellers are sourced to the same jurisdiction as sales by in-state vendors, or requiring all counties, cities, and towns to impose taxes at the same rate. In addition, lawmakers should consider the best way to eliminate, or at least minimize, the other burdens described above that the state imposes on remote sellers.

To that end, if Arizona is not going to adopt the SSUTA to eliminate or at least minimize the burdens it imposes on remote sellers, it should consider offering free software to retailers to help them navigate the state's unique sales tax system and providing immunity from audit liabilities to retailers that rely on such software to make taxability and tax rate decisions.

Finally, as I pointed out in my last column,[17] during this legislative session, lawmakers created a trap for the unwary by including all of the options for municipalities to tax items not taxed by the state in a separate statute that makes no references to these options in the state's retail tax statute, A.R.S. section 42-5061. They easily could resolve this trap for the unwary during their next legislative session by simply adding a provision in the state's retail tax statute that cross-references the statute they added this session[18] that includes all of the options for municipalities to tax items not taxed by the state, or by simply moving those provisions into the state's retail tax statute, A.R.S. section 42-5061.[19] ■

[16] For instance, the Arizona Legislature did not enact S.B. 1155, a bill promoted by the business community, which would have established a committee to study and make recommendations to lawmakers concerning actions the state should take to implement economic nexus provisions following *Wayfair*.

[17] Busby, *supra* note 3.

[18] A.R.S. section 42-6017.

[19] Laws 2019, Ch. 273, section 11.