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Use Tax on Remote Sales

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Assembly Revenue and Taxation Committee

Hon. Autumn R. Burke, Chair

Senate Governance and Finance Committee

Hon. Mike McGuire, Chair





California's Sales and Use Tax

- Sales and Use Tax Plays Major Role in California's Tax System.*** The sales and use tax has two parts: a sales tax on tangible goods sold by California retailers, and a use tax on tangible goods purchased from other retailers—including out-of-state retailers. Combined, they are the second-largest revenue source for the state's General Fund and a significant source of revenue for many local governments. In 2016-17, the sales and use tax raised \$53 billion for California's state and local governments, including \$25 billion for the state's General Fund. (Roughly one-tenth of sales and use tax revenue comes from the use tax.)

- Sales and Use Tax Rates Vary Across Cities and Counties.*** There are 24 distinct rates levied, ranging from 7.25 percent to 10.25 percent. The average rate is roughly 8.5 percent.

- California Department of Tax and Fee Administration (CDTFA) Administers Sales and Use Tax.*** CDTFA—a department within the Government Operations Agency—inherited the sales and use tax program from the State Board of Equalization in 2017.

The Use Tax

- ☑ ***Purchases From Remote Sellers.*** Tangible goods sold by retailers located in California are subject to sales tax. When Californians buy goods from out-of-state (that is, remote) sellers, those purchases generally are subject to use tax.

- ☑ ***Use Tax Examples.*** Use tax is due in these common situations:
 - ***Making Online Purchases From Out of State.*** Use tax applies to tangible goods Californians purchase from remote sellers over the Internet.

 - ***Bringing Out-of-State Purchases Into California.*** Californians purchase tangible goods while they are traveling outside of the state. When they use those goods in California, they owe California use tax.

 - ***Buying a Car From a Private Party.*** When individuals buy used cars directly from other individuals, they owe use tax.

- ☑ ***Challenges: Awareness and Enforcement.*** Many California consumers are not familiar with the use tax, leading to uneven compliance. One way to increase compliance is to collect use tax from sellers rather than buyers. However, courts long have interpreted the U.S. Constitution's commerce clause in a way that limits states' ability to collect use tax from remote sellers. *Wayfair* changed some of these restrictions.



Collecting Use Tax From Remote Sellers



Key Legal Concepts.

- **Substantial Nexus.** In *Complete Auto Transit v. Brady* (1977), the Supreme Court of the United States (SCOTUS) established a multipart test to determine whether a state tax unduly burdens interstate commerce. A key part of the test: Does the taxed activity have a substantial nexus with the taxing state?
- **Physical Presence.** In *Quill Corp v. North Dakota* (1992), SCOTUS ruled that North Dakota could not require Quill Corporation to remit use tax because the business had no physical presence in the state. This physical presence requirement originated in an earlier SCOTUS decision, *National Bellas Hess, Inc. v. Department of Revenue of Illinois* (1967).



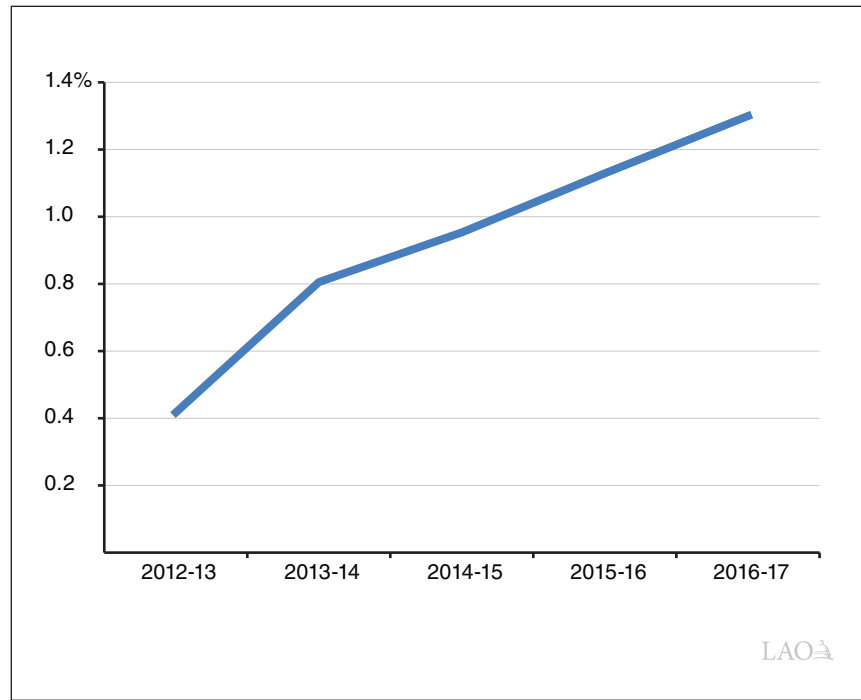
2011 Law Strengthened California Use Tax Collection

Requirements. Chapter 313, Statutes of 2011 (AB 155, Calderon and Skinner) expanded California's use tax collection requirements within the physical presence framework established by *Quill*. Under AB 155, all retailers "engaged in business" in the state must register to pay use tax. In particular, this requirement applies to:

- Remote sellers in the same "commonly controlled group," or corporate family, as in-state businesses.
- Remote sellers who work with in-state affiliates—people who refer potential customers to those retailers.



AB 155: A Small but Growing Share of Sales and Use Tax Revenue



- In 2016-17, businesses registered under AB 155 paid nearly \$700 million in use tax, accounting for 1.3 percent of total sales and use tax revenue.
- AB 155 revenue has grown much faster than other sales and use tax revenue.



South Dakota v. Wayfair, et al. (2018)

- South Dakota's Sales Tax Law.*** In 2016, South Dakota passed a law requiring remote sellers to pay sales tax if they meet one of two conditions in the prior or current calendar year:
 - The remote seller's gross revenue from sales to South Dakota exceeds \$100,000.
 - The remote seller made 200 or more separate sales transactions to South Dakota.

- Lawsuit.*** South Dakota sued remote sellers who were not complying with the new requirements. The trial court and State Supreme Court ruled in favor of the remote sellers, citing the physical presence requirement established in *Quill* and *Bellas Hess*.

- SCOTUS Decision.*** SCOTUS overruled *Quill* and *Bellas Hess*, eliminating the physical presence requirement and vacating the lower court rulings. The court found that the South Dakota law met the substantial nexus requirement established in *Complete Auto*.