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HEADS UP, ONLINE RETAILERS! HOW A RECENT U.S. SUPREME COURT DECISION ON SALES & USE TAX POTENTIALLY CHANGES EVERYTHING AND NOTHING AT ALL IN TEXAS

by Ricardo Rivera and Isreal Miller, Gray Reed & McGraw
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On June 21, 2018, the United States Supreme Court ruled in that states can compel online retailers to collect and remit sales tax to states in which those retailers have no physical presence. This was a historic decision as it puts brick-and-mortar retailers on more “equal footing” with their online competitors to the extent that the latter will also have to collect and remit sales tax.

What follows is a brief review of the significance of the Supreme Court’s decision in this tax case involving South Dakota, the current sales and use tax rules in Texas, and the impact that this case might have on future tax legislation in the Lone Star State.

So why all the fuss about *South Dakota v. Wayfair*?

In *South Dakota v. Wayfair*, the United States Supreme Court overturned its 1992 decision in *Quill v. North Dakota*, a case that indicated a physical presence in a state was required in order for the state to constitutionally impose an obligation on a retailer to remit sales and use tax to that state.

The *Wayfair* case specifically involved South Dakota’s “economic nexus law”, which obligates out-of-state sellers to collect and remit sales tax if they have more than \$100,000 of annual sales into the state or, in the alternative, more than 200 in-state transactions. South Dakota is not the only state with a law that has what is known as an “economic nexus model” and imposes an obligation on out-of-state sellers that exceed certain gross sales or transaction thresholds to collect and remit sales tax. There are approximately 20 other states with similar laws. Of those, only Tennessee, Washington and Wyoming do not impose a state income tax.

Although *Wayfair* may be a sign of changing times, Texas does not tend to be an early adopter of new ideas. It has yet to enact a law or adopt a regulation that creates taxable nexus based strictly on economic activity. “Nexus” exists when a company has sufficient contact with or activity within a state to require that person or entity to remit sales and use tax to that state. Texas currently requires some degree of activity in the state before requiring online and out-of-state retailers to remit sales and use tax.

I operate online or out-of-state. Do I have to collect and remit sales tax on sales to Texas residents?

Unfortunately, it depends on a number of factors.

Texas imposes a sales tax on the sale of tangible personal property and taxable services in the state. Items that are purchased outside of Texas but stored, used or consumed in the state are taxed to the purchaser via a use tax.

A seller’s activity in Texas will give rise to an obligation to collect and remit sales tax if it has a “place of business” in Texas because the seller will clearly have nexus in the state. A seller that does not have a place of business but is otherwise “engaged in business” may also have an obligation to collect and remit sales tax in Texas. These two scenarios might seem

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easy to distinguish, but many retailers do not think that they have a place of business in Texas when they actually do, and even more sellers that do not have a place of business are otherwise “engaged in business” in Texas but don’t know it! How is this possible? Read on.

A place of business is typically an office, an outlet or any kind of physical location operated by the seller. Although these examples might seem obvious, what constitutes a “place of business” under Texas law is quite broad. For example, a home office out of which three or more items are sold through an online auction website is a place of business. This example is part of the definition of “place of business” in the Texas Administrative Code. Such a seller might think that because he or she is operating online, he or she does not have a “place of business” in Texas but he or she would be mistaken.

The Texas Tax Code provides additional context by establishing rules that allow online and out-of-state sellers to determine where a sale is deemed to occur and, consequently, if they have an obligation to collect and remit Texas sales tax. For example, the Texas Tax Code indicates that a seller is obligated to collect sales tax on taxable items delivered to customers in Texas if the goods sold are either stored or delivered from a location in Texas. This explains why online and out-of-state sellers that sell goods via an Amazon Fulfillment Center within the state have to collect and remit sales tax on all sales made to buyers in Texas.

Even without a “place of business”, as an online or out-of-state seller you might still be “engaged in business” in Texas. The Texas Administrative Code defines what it means to be “engaged in business” in Texas by providing numerous examples. Some of the examples in the statute, like “maintaining an office in the state”, make it clear that the seller is engaged in business in Texas and thus has to collect and remit sales tax. Other examples, such as “allowing a franchisee or licensee to operate under its trade name in this state if the franchisee or licensee is required to collect sales or use tax in this state”, are less intuitive.

Section §151.107(a)(5) of the Texas Tax Code imposes on online and out-of-state sellers an obligation to collect sales and use tax without establishing either gross receipts or transactional activity thresholds that would constitute “economic nexus” under *Wayfair*. The statute indicates:

“[A] retailer is engaged in business in this state if the retailer

...

(5) solicits orders for taxable items by mail or through other media and under federal law is subject to or permitted to be made subject to the jurisdiction of this state for purposes of collecting the taxes imposed by this chapter”.

This language ostensibly imposes on all online and out-of-state sellers with customers in Texas an obligation to collect and remit sales tax by deeming them to be “engaged in business” in the state regardless of their level of activity.

An online or out-of-state seller that is deemed to be “engaged in business” in Texas has to obtain a sales and use tax permit from the Texas Comptroller and would be responsible for collecting and remitting sales and use tax until it ceases to have “nexus”.

But I have never collected and remitted sales and use tax to Texas. Why worry now?

Unlike South Dakota, Texas has yet to enact a law or adopt a regulation that creates nexus based strictly on economic activity and whether or not such a statute will be adopted in the next legislative session is anybody’s guess. That said, there are those who believe that such legislation is not needed. The current Texas Comptroller of Public Accounts, the Honorable Glenn Hegar, recently issued a memo in which he stated:

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“With appropriate notice, and **prior to legislative action, Tax Code § 151.107(a)(5) (Retailer Engaged in Business in the State) could be imposed on remote sellers to the extent they “[solicit] orders for taxable items by mail or through other media,”** meaning, for example, sellers who solicit sales in Texas through catalogs and emails.”

Put simply: the Texas Comptroller believes that both online and out-of-state sellers have an obligation to collect and remit Texas sales tax under the current statutory framework. The lack of a gross sales or transaction threshold might expose the current framework to legal challenges such as the one South Dakota faced in the *Wayfair* case. The Comptroller anticipates this, as his memo also indicates “we are reviewing agency rules that need amending to ... explain the amount of economic nexus in sales and/or transactions required to create a safe harbor for small sellers”.

It probably does not bode well for online and out-of-state sellers because, like South Dakota, Texas does not impose a state income tax and relies heavily on sales and use tax revenue to fund essential services. According to a recent article published in the online version of *The Dallas Morning News*, in 2014, the former Comptroller estimated that Texas could gain more than \$1 billion in combined state and local taxes if internet sales were taxed. While this number might have gone down given that large online sellers like Amazon are currently collecting and remitting Texas sales tax, I believe we will see increased efforts to enforce existing rules and guidelines that apply to online and out-of-state sellers as Texas tries to increase sales and use tax collections.

Overall, the U.S. Supreme Court’s decision in *Wayfair* serves as both a reminder of existing obligations and a sign of things to come for taxpayers doing business in Texas.

Next Steps

Regardless of whether you have an actual “place of business” in Texas or you operate remotely but are “engaged in business” in the state, it’s critical to comply with your sales and use tax reporting and remittance requirements. If you have outstanding sales and use tax obligations, it’s best to work with an attorney who can provide the guidance to help you both get up to date with your obligations and minimize your exposure to penalties and interest.

ABOUT THE AUTHORS



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Ricardo Rivera has broad experience in tax and corporate transactional matters. He has an extensive background in handling and structuring business transactions, partnership and corporate tax planning and corporate governance in a variety of areas. Prior to joining Gray Reed, Ricky served as Director & Tax Counsel for American Airlines, where he was in charge of federal taxes, international taxes with a focus on Latin America, and employee benefits and executive compensation issues. He received his his J.D., magna cum laude, from the University of Puerto Rico School of Law; and his LL.M. in Taxation with a Certificate in Employee Benefits Law from the Georgetown University Law Center. He is also a CPA and a member of the Texas Society of Certified Public Accountants.



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Isreal Miller is a tax attorney focused on state and local taxation matters (primarily Texas sales and use tax and franchise tax). Prior to joining Gray Reed, Isreal served for five years as a trial attorney for the Texas Comptroller of Public Accounts. While at the Comptroller’s office, he personally handled over 1,700 cases and litigated over 850 of those cases. During his work at the Comptroller, he gained extensive experience working with taxpayers, taxpayer representatives, auditors, and other agency personnel to resolve disputed state tax issues and claims. Isreal earned his J.D. from Texas Tech University; and his LL.M. in Taxation from Southern Methodist University Dedman School of Law. Isreal is also a Certified Public Accountant in Texas and a Certified Financial Planner™ professional.

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