

PUBLICATION

Spotlight on Tennessee: After *Wayfair*, Sales and Use Tax Compliance for Tennessee E-Commerce

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The U.S. Supreme Court's decision in *South Dakota vs. Wayfair, Inc. et al.* represents a significant change in the sales tax collection and remitting responsibilities of all businesses, large and small, selling at retail across state lines by means of e-commerce. Baker Donelson published a first look at this landmark decision on June 26. On July 9, we began providing state-specific compliance analysis in light of the *Wayfair* decision. This alert continues our state-specific analysis of the *Wayfair* decision by addressing the current status of sales tax e-commerce compliance in Tennessee.

Revenue Department Considering Options

As explained in greater detail below, the Tennessee Department of Revenue (TN DOR) adopted an administrative rule with the intent beginning in 2017 to require sales tax collection from certain e-commerce dealers who do not have a physical presence in Tennessee. Despite this, the TN DOR has been prevented from enforcing that administrative rule so as to require collection and remittance of tax by e-commerce sellers because of a court order and subsequent legislative action. Based on informal discussions with senior officials in the TN DOR, it is apparent that the TN DOR is considering its options for purposes of enforcing that rule at some point. At present, it also appears that the TN DOR does not intend to impose any retroactive tax obligations on dealers who lack physical presence in Tennessee under the standards in effect prior to the *Wayfair* decision and will only require collection prospectively once the TN DOR's authority to enforce such rule has been renewed.

Statutory Background

In 1988, Tennessee enacted an amendment to the definition of "dealer" which sought to expand Tennessee's sales or use taxing jurisdiction to include certain remote sellers (that is, sellers with no physical presence in the State) taking advantage of Tennessee's economy. That statutory enactment, currently found at Tennessee Code Annotated, Section 67-6-102 (23) (J), defines "dealer" to include every person who "(e)ngages in the regular or systematic solicitation of a consumer market in this state by the distribution of catalogues, periodicals, advertisements fliers, or other advertising, or by means by print, radio or television media, by telegraphy, telephone, computer data base, cable, optic, microwave, or other communication system." When that statutory enactment became effective January 1, 1989, it was met with resistance from remote sellers. They relied on the 1967 decision by the U.S. Supreme Court in *National Bellas Hess, Inc. v. Department of Revenue of Ill.* and the Court's subsequent 1992 decision in *Quill Corp. v. North Dakota* – both of which stood for the proposition that the 'substantial nexus' requirement for validly imposing a tax under the Commerce Clause of U.S. Constitution necessarily required that the remote seller have physical presence within the taxing state.

Fast forward two decades to the Supreme Court's 2015 decision in *Direct Marketing Association v. Colorado Department*. In that decision, Justice Kennedy concurred with the majority that upheld Colorado's notice requirement, but he also invited a reexamination of both *Quill* and *Bellas Hess*. Among the reasons for such invitation, Justice Kennedy cited the dramatic intervening and far-reaching systematic and structural changes in the U.S. economy brought about by the Internet.

Rule 129(2)

Following up on that invitation, and in the wake of enforcement activities by various other states such as South Dakota and Alabama, the TN DOR in October 2016 filed with the Tennessee Secretary of State proposed Sales and Use Tax Rule 1320-05-01-.129. Subparagraph (1) of that Rule sought to address the Tennessee sales or use tax compliance requirements with respect to out-of-state dealers having a physical presence in the state. Subparagraph (2) of the Rule (herein 'Rule 129(2)') sought to address those compliance requirements applicable to remote sellers without a physical presence in the State.

Rule 129(2) provides that remote sellers with no physical presence in Tennessee who engage in regular systematic solicitation of consumers in Tennessee and who make sales exceeding \$500,000 to consumers in the State during the previous 12-month period shall be considered as having "substantial nexus" with Tennessee for sales or use tax collection remittance purposes. Rule 129(2) also provided that by March 1, 2017 those remote sellers meeting such threshold shall register with the TN DOR for sales or use tax purposes and thereafter, beginning July 1, 2017, start collecting and remitting such taxes to the TN DOR. For remote sellers who meet the sales volume threshold after March 1, 2017, those remote sellers are required by Rule 129(2) to register with the TN DOR and begin to collect and remit sales and use taxes by the first day of the third calendar month following the month in which the remote seller met such threshold.

In testimony before the Tennessee Joint Government Operations Committee in December 2016, and as part of the Legislative review of proposed Rule 129(2), the TN DOR advised the Committee that the authority to require remote sellers to collect and remit such tax stems from the 1988 enactment found at Tennessee Code Annotated, Section 67-6-102(23)(J).

Intervening Litigation/ Legislation

The promulgation of Rule 129(2) was almost immediately met with litigation. Suit was filed in March 2017 in the Davidson County (Nashville) Chancery Court challenging the constitutionality of Rule 129(2), such suit being styled *American Catalogue Mailers Association v. Tennessee Department of Revenue*. That challenge ultimately led to an agreed order being entered in April 2017 by the Chancery Court that delayed the enforcement of Rule 129(2) while the challenge was pending.

Perhaps more importantly, however, the 2017 Legislature also weighed in on Rule 129(2). In that regard, 2017 Public Chapter No. 452 was enacted in May 2017. That Public Chapter states in part that the TN DOR "shall be prohibited from collecting any internet sales or use taxes authorized under [Rule 129(2)] and permitted under a ruling of any court, until such court's ruling has been fully reviewed and [Rule 129(2)] has been approved by the general assembly pursuant to" the Legislature's various oversight and related powers pertaining to rules promulgated under Tennessee Law.

Later in May 2017, the TN DOR issued its Notice #17-12 in which the TN DOR referenced its earlier Notice #17-01 (issued in January 2017) but then reviewed the then-current status of the above-referenced litigation as well as 2017 Public Chapter No. 452. The TN DOR did state at that time that if an out-of-state dealer meeting the requirements of Notice #17-01 does begin to collect or remit tax on or before July 1, 2017, the TN DOR would certify that it would not audit or access the business for periods prior to the date the dealer began to collect or remit such tax.

Outlook Following *Wayfair*

On June 21, 2018, the Court's decision in *Wayfair* overruled the *Quill* and *Bellas Hess* precedents and held that substantial nexus with a taxing state will no longer require physical presence. In its ruling, the Court was addressing South Dakota's statute which required remote sellers to comply with that State's sales tax collection and remittance obligations if the remote seller had more than \$100,000 in annual sales in goods or services

into South Dakota, or engaged in 200 or more separate transactions for delivery to residents of that State during a year.

The *Wayfair* decision certainly bolsters the TN DOR's outlook for enforceability of Rule 129(2) from a constitutional standpoint. However, various procedural issues still remain such as whether Rule 129(2) must first be approved by the General Assembly in 2019 as arguably indicated by 2017 Public Chapter No. 452. Significantly, Rule 129(2) does not include the alternative transactional threshold as was present in the South Dakota statute approved by the Court in *Wayfair*, which (if left as is) potentially provides room for further constitutional challenges.

Based on the earlier referenced informal discussions with the TN DOR, it appears that the TN DOR is considering various alternative procedures for moving forward with the ultimate objective of enforcing some form of economic presence either through the existing or an amended Rule 129(2), or perhaps through a new statutory enactment. In that regard, it is possible that the \$500,000 threshold currently in Rule 129(2) would be reduced to a lower figure. It is not yet clear when any newly expanded collection responsibility will take effect. Fortunately, at present it appears that the TN DOR does not intend to enforce the existing Rule 129(2) or any new e-commerce tax collection standards on a retroactive basis.

Conclusion

On July 9, we began providing state-specific compliance analysis in light of the *Wayfair* decision. This alert continues our state-specific analysis by addressing the current status of sales tax e-commerce compliance in Tennessee. Please view our Alabama analysis in our [Spotlight on Alabama](#) alert, and our Georgia analysis in our [Spotlight on Georgia](#) alert.

Baker Donelson stands ready to assist businesses of all sizes in understanding and complying with Tennessee's e-commerce sales and use tax requirements. If you have any questions on how the *Wayfair* decision will affect your sales business in Tennessee, please contact [Carl Hartley](#) (Chattanooga), [William Fones](#) (Memphis), [Steve Wood](#) (Nashville) or any member of the Firm's [Tax Group](#).