

Reflections on the Past 15 Years

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I was asked to comment on the changes I have seen in the practice of state and local taxes since I served as Chair of the SALT Committee in 2001 through 2003. Upon reflection and review of old periodicals and seminar materials (note to librarian: I told you I would need those documents one day), it strikes me that, while we still litigate the same substantive questions (nexus, apportionment, scope of exemptions, etc.), the facts and circumstances giving rise to those questions have, in many instances, changed. Further, the way we practice has substantially changed. These changes were brought about in large part by the decline of the more traditional forms of commerce, the continued growth of electronic commerce, commerce's effect on how business is done, and the widespread use of more sophisticated information technology by practitioners.

For instance, in 2001 Blockbuster had 7,000 stores located throughout the United States. It earned \$5 billion in revenue from its sales and rentals of DVDs and CDs. It had just passed up the opportunity to buy Netflix for \$50 million. Today Netflix is located in the Cloud and has more than 27 million subscribers to its streaming services, more than 8 million subscribers to its DVD rental service, and annual revenues in excess of \$1 billion. Blockbuster is bankrupt and closed its last store in 2014.

Part of Blockbuster's fall was due to the decline in sales of physical copies of CDs and DVDs, which peaked in 2003. That was the year Apple began offering digital downloads. In 2003, sales of CDs accounted for 93% of all music sales. Today, digital downloads account for 64% of music sales, and even those sales are being seriously eroded by the rise of streaming services.

In 2001, sales of electronic books represented a miniscule portion of all book sales. Borders, a leading retailer of paper books at the time, decided to outsource its online book sales to Amazon and concentrate on sales at its brick-and-mortar stores. Bad decision! Today, electronic books make up more than 22% of all book sales. Amazon is thriving, and Borders doesn't exist.

Overall, electronic commerce sales in 2001 were approximately 1.1% of total retail sales in the United States. By 2014, electronic commerce sales constituted 6.5% of total sales. What this signifies is that commerce is shifting from its traditional form of a customer walking in, buying, and walking out with tangible personal property to one of a customer clicking in to a website and having an out-of-state retailer ship the property to the customer. In other

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instances the customer buys digital property or pays for digital services that are received electronically. Not unexpectedly, state and local tax revenues from sales taxes were adversely impacted because their sales and use tax statutes had been enacted when society's consumption of tangible personal property greatly exceeded sales of services, tangible personal property was something you could actually see, and buying from remote sellers largely consisted of ordering items out of the Sears & Roebuck and Montgomery Ward catalogs.

State and local authorities have attempted to protect their revenues by "modernizing" their laws. Some enacted "Amazon laws" designed to expand the nexus net so that remote retailers would have to collect and remit sales taxes. Some states apply the concept of economic nexus to insure that out-of-state companies pay the local income tax. Others expanded their definitions of tangible personal property and taxable services through legislation, regulation, or by adopting a "they're taxable because we say they're taxable" attitude to capture transactions which were once thought not to have been taxable. Just like they were in 2001, practitioners are still litigating whether transactions come within the scope of the law, whether regulations are valid, and whether *ipse dixit* can serve as the basis for a tax. Of course, there are, and probably always will be, disputes over nexus.

As electronic commerce expands, the number of taxpayers doing interstate business likewise increases. This has led to a concomitant rise in nexus issues for both the sales and income tax. For example, I recently handled a matter where a software program was developed in Louisiana and loaded onto servers located in another state from where it could be accessed by users throughout the United States. Determining which states considered my client as having nexus for purposes of both the sales and income tax was not straightforward. A generally accepted, cohesive theory of nexus continues to be an elusive concept in the area of state and local taxes, and it does not appear that we are any closer to an answer.

In 1992, the Supreme Court, in *Quill*, suggested that Congress get involved and legislatively overturn the Court's decision in *Bellas Hess* that nexus, for purposes of collecting a sales tax, required a physical presence. Since then, tax collectors have lobbied Congress, unsuccessfully so far, to enact the Marketplace Fairness Act, which would compel remote sellers to collect local taxes. Remote sellers apparently do not see the fairness in the Marketplace Fairness Act and have successfully, so far, lobbied against its enactment. The Marketplace Fairness Act of 2015 was recently introduced, so Congress will try again this year.

At least one member of the Supreme Court has, however, apparently given up on Congress acting. Justice Kennedy, in *Direct Marketing*, implored the tax bar to bring a case the Court could use as a vehicle for overturning *Bellas Hess*. I am sure the bar will rise to that challenge with the only question being how long it will take for such a case to slowly wind its way up to the Court. Of course, one thing that has not changed since 2001 (or since Shakespeare's time for that matter) is that we must still suffer the law's delays.

The rise of electronic commerce has also changed other areas of taxation. For instance, how income is apportioned among the states in which a company does business and what constitutes a “fair apportionment” of that income for income tax purposes are still key issues in our practice. In 2001, the standard model for apportioning income was a three-factor formula consisting of ratios of in-state property, payroll, and sales to total everywhere. With the growth of electronic commerce, more states have gone to the use of formulas that double-weight sales or even use sales as the single factor, since a company can receive substantial revenue from a state without having any property or employees in that state. With more services being provided on the Internet, some states now source revenues from services to the place where the benefit is received as opposed to the state where the service was actually performed.

Another issue practitioners were dealing with in 2001 was the forum in which tax cases should be tried. Lawyers representing taxpayers have long advocated establishing independent tax tribunals. Lawyers representing tax collectors prefer a home-field advantage. In 2006, the ABA adopted the Model State Administrative Tax Tribunal Act, which grew out of a project of the SALT Committee. Slowly but surely, states are moving toward a more neutral tribunal. Even Louisiana and Alabama recently revised their procedures for contesting taxes such that the issues are heard by persons who are independent of the tax collector. If those two states can do it, then there is hope for every state.

While many of the legal issues facing practitioners in 2015 may be similar to those they faced in 2001, the way practitioners practice has certainly changed. In 2001, most of us had computers in our offices, which were big ugly boxes occupying a lot of space on one’s desktop and took forever (at least by today’s standards) to do what you wanted it to do. Now you can carry a computer in your pocket or purse, and how fast it works depends on the number of “bars” available.

In 2001, our research sources were housed in rooms just down the hall from our offices. For smaller firms, these sources were largely limited to those relative to our home state and the federal government. Now, our research sources reside on the Internet and are accessible from almost any place you happen to be. Even the smallest firms can research how all 50 states, the District of Columbia, and other jurisdictions have addressed a particular issue. I had occasion to cite a decision issued by a Hawaiian court in the 1960s on one particularly obscure Louisiana issue.

The way we communicate has also changed. In 2001, our mobile phones were likely made by Nokia or Motorola and were just phones. Now Samsung and Apple are the leading manufacturers, and our mobile devices are our constant companions and function as computers, calculators, calendars, cameras, recorders, and entertainment centers that can suggest a restaurant, guide us there, pay for the meal, and chide us for the number of calories we consumed while there. They are phones almost as an afterthought. Soon we may jettison these devices for a watch.

The way we communicate with clients has also changed. In 2001, we played phone tag with clients and faxed or even mailed documents to them. Now we use e-mail instead of mail, texts instead of e-mailw, and scans instead of faxes. We deliver packages and documents by private overnight services. The historic institution of the USPS is used primarily for firm announcements and holiday greetings.

So while we still apply the same legal concepts, those concepts are being applied to fact patterns that were uncommon in 2001 but are now the norm because of how our economy has evolved. As our economy continues to change the tax system will, as any parasite would, evolve. As the tax system mutates, the way we treat, and deal with, issues created by the tax system will also change. Indeed, the one thing that will never change in the SALT practice is that the SALT practice will always be changing.

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¹Taken from proceedings and other news published in THE TAX LAWYER and its predecessor, the BULLETIN, which was published from 1947–1967. Based on Committee proceedings published in 1947, the Committee on State and Local Taxes was established in 1946. Prior to 1946, there were a number of Tax Section committees devoted to aspects of state and local taxation.