D.C.'s Attempt to Force Remote Sellers To Collect Sales Tax

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A surprising late contender to the legislative nexus battles, the District of Columbia has exploded onto the scene by passing the District of Columbia Main Street Tax Fairness Act as part of its fiscal 2012 budget.[1] The act grants the district the ability to require non-physically present remote sellers to collect the district's sales and use tax. The act overturns the long-standing physical presence dormant commerce clause nexus standard applied in *Quill*[2] if the district adopts some sales tax simplification requirements. In this Pinch of SALT, we discuss the requirements of the district's Main Street Fairness Act and explore whether it will lead to the erosion of the *Quill* physical presence standard across the United States.

Overview of the Proposed Act

The district's proposed approach to remote sales and use tax collection vaguely resembles the federal Main Street Fairness Act[3] and, to a much lesser degree, the Streamlined Sales and Use Tax Agreement.[4] The act cherry-picks some of the administrative simplification provisions from the SSUTA. In so doing, the district is undermining the SSUTA's goal of significant simplification and uniformity.

The act requires remote vendors to collect remote sales tax on sales made into the district, but only if the district government adopts, within 120 days of enactment by Congress, specific laws or rules intending to simplify the district's sales and use tax laws.[5] The act requires that the district government establish, "pursuant to local law," the following:

- a registry, with privacy and confidentiality controls so that it cannot be used for any purpose other than the administration of remote sales taxes;[6]
- an unspecified small-seller exemption;[7]
- "a means [possibly matrices] for a remote-vendor to determine the current District sales and use tax rate and taxability;"[8] and
- an unspecified level of "reasonable compensation" for remote vendors for the administration, collection, and remittance of remote sales taxes.[9]

The act would also require the district's Office of Tax and Revenue to promulgate rules addressing bad debt deductions; rounding; refunds and credits for remote sales taxes relating to returns, restocking

[1] *See* http://dccouncil.us/fy12budget for a link to the district's budget documents and related information.

[2] *Quill v. North Dakota*, 504 U.S. 298 (1992).

[3] H.R. 5660, 111th Cong., 2d Sess. (2010).

[4] *See* http://www.streamlinedsalestax.org/index.php?page=modules.

[5] *See* http://dccouncil.us/media/fy12budgetreport/fy12budget_bsa_amendinnat ureofsubstitute.pdf (see subtitle R (Main Street Tax Fairness Act)). A remote vendor is defined as "a seller, whether or not it has physical presence or other nexus within the District of Columbia selling via the internet property or rendering a service to a purchaser in the District." Proposed D.C. Code section 47-3931(3). Importantly, this definition does not encompass all remote vendors, such as those selling via catalogs or other mail-order methods. Remote sales taxes encompass the district's sales and use taxes "when applied to property or service sold via the internet to a purchaser in the District."

[6] Proposed D.C. Code section 47-3932(a)(1).

[7] Proposed D.C. Code sections 47-3932(a)(6), 47-3932(a)(1), and 47-3931(1) (defining exempted vendor as "a remote-vendor that in accordance with local law has a specified level of cumulative gross receipts from internet sales to purchasers in the District that exempt it from the requirement to collect remote sales taxes").

[8] Proposed D.C. Code section 47-3932(a)(3).

[9] Proposed D.C. Code section 47-3932(a)(4)(A), (B).

fees, discounts, coupons, shipping, registration notification and procedures; and any other issue the mayor determines as being "necessary and appropriate to further the purposes of this chapter."[10] Finally, the district must adopt a "plan to substantially reduce the administrative burdens associated with sales and use taxes, including sales tax collection by remote vendors."[11] However, like the SSUTA, the act does not require the district to tax or exempt any product, adopt a particular type of tax, or impose tax at the same rate as any other taxing jurisdiction that collects remote sales taxes.[12]

The district's Main Street Tax Fairness Act provisions fall short in several critical areas:

- clarification that registration by a remote vendor cannot be used as evidence of a nexus determination for any tax other than remote sales taxes, for example, corporate income tax;[13]
- specified method for determining reasonable vendor's compensation, or an actual percentage that a remote vendor may deduct;[14]
- hold harmless protection for a remote vendor's (and purchasers') reliance on sales and use tax rate and taxability information and systems provided by the district;[15]
- class action protection for overcollection of sales and use taxes;[16]
- uniform definitions and sourcing rules;[17] and
- a requirement that the district participate as a full member in the SSUTA's simplification and uniformity provisions.

Because Congress rarely amends or rejects tax provisions in the district's budget, it is unlikely that Congress will provide those additional protections to remote vendors. To the extent that Congress disapproves of or amends district budget legislation, it typically reserves its supervisory prerogative for politically charged issues. Because the imposition of a remote vendor tax collection obligation has been the subject of much debate for many years, we contend that the district's effort to end-run the 11-year simplification effort is an instance in which Congress should consider exercising its plenary authority to disapprove of the act.

[10]Proposed D.C. Code section 47-3932(a)(8).
[11]Proposed D.C. Code section 47-3932(a)(9).
[12]Proposed D.C. Code section 47-3933; *see also* SSUTA section 103; section 7(d) of H.R. 5660, 111th Cong., 2d Sess. (2011).
[13]*See s*ection 8, H.R. 5660, 111th Cong., 2d Sess. (2011).
[14]*See* SSUTA sections 605-613.
[15]*See, e.g.*, SSUTA section 331.
[16]*See* SSUTA section 325.
[17]*See* SSUTA section 310; Library of Definitions.

Does the District's Legislative Process Result in a Congressional Overturn of *Quill*?

No state or locality can unilaterally upend the U.S. Supreme Court's dormant commerce clause jurisprudence. However, the Court in *Quill* invited Congress to do exactly that: "Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes."[18] Because of the unique process by which the district's laws are enacted (including Congress's role in the process), it is critical to gain an understanding of the legislative procedures of the district's Budget Support Act (BSA) (the revenue portion of the fiscal 2012 budget) and its Budget Request Act (BRA) (the appropriations portion of the fiscal 2012 budget).

Budget Support Act — Enactment of 'Local' District Legislation

The district's Main Street Tax Fairness Act is part of its BSA, which the city council passed on June 14. The legislation likely will have been transmitted to, and signed by, the mayor as this Pinch goes to press. Following the mayor's signature, the BSA goes to Congress for a "passive" 30-day review period.[19] The BSA is reviewed in the House of Representatives by the Committee on Oversight and Government Reform and in the Senate by the Committee on Homeland Security and Governmental Affairs.[20]

During the 30-day review period (measured by days that both the House and Senate are in session), Congress may enact a joint resolution disapproving of the BSA.[21] To prohibit the BSA from becoming law, the president must also sign the joint resolution within the 30-day period.[22] Unless this disapproval process takes place, the BSA becomes part of the D.C. Code (but not part of the federal statutory laws).[23]

Because of the manner in which the 30-day review period is measured, the passive 30-day review period typically expires some time around September or October — just before Congress adjourns. Thus, the nexus provisions contained within the BSA (which may take effect as early as 120 days after the effective date) likely would not go into effect until early 2012.

Historically, Congress has disapproved of the city council's legislation on only three occasions — none of which related to the district budget — since Congress granted the district limited self-governing authority by adopting the District of Columbia Self-Government and Governmental Reorganization Act

[18]*Quill*, 504 U.S. at 318.
[19]D.C. Code section 1-206.02(c).
[20]*Id.*
[21]*Id.*
[22]*Id.*
[23]*See id.*

of 1973 (Home Rule Act).[24] To our knowledge, Congress has neither disapproved of a district budget nor line-item-vetoed any district bill during the 30-day review process. However, nothing in the Home Rule Act precludes either congressional committee from amending the BSA or rejecting it in its entirety.[25]

Budget Request Act — Enactment of District Law as a Federal Agency

The Main Street Tax Fairness Act is also contained in the district's BRA. Although it may seem unusual that the act is part of the BRA, which generally contains appropriation (district spending) items, it does not appear that there is a strict prohibition from including non-appropriation items in the BRA.[26] The district has inserted such items into the BRA on prior occasions.[27]

The BRA passed the city council by voice vote and has been transmitted to the mayor for review. The mayor is expected to sign the BRA and send it to the president, who will then transmit it to Congress along with other federal agency budget requests.

Procedurally, the BRA is very different from the BSA.[28] For federal budget purposes, the district is treated as a federal agency.[29] The BRA is included in the federal appropriations bills, subject to review by the Office of Management and Budget, and ultimately transmitted by the president to Congress for review. All district spending — whether federal funds or funds generated from district sources (for example, local sales tax or personal income tax) — must be approved by Congress in its appropriations bill.[30] Once the appropriations bill that contains the BRA comes out of the House and Senate Appropriations committees, the legislation is sent to the floor in both chambers, approved by Congress, and ultimately sent to the president for signature.[31]

Generally, Congress does not change the BRA's tax-related provisions. As with the BSA, Congress tends to amend only provisions related to political or partisan matters, such as funding for Planned Parenthood, gun control, or school vouchers.

Is the District's Main Street Fairness Act Constitutional?

The district's status as a federal enclave and its unique legislative process raise questions about whether the district's Main Street Tax Fairness Act comports with U.S. constitutional standards. Although this Pinch of SALT highlights some of issues that will face the district should the BSA or the BRA become law, we do not provide an exhaustive list of all potential challenges. Instead we discuss the commerce clause implications as well as those of the Constitution's district clause,[32] a provision that gets little attention beyond the Beltway.

As an initial matter, Congress has ultimate control over the district despite the power it granted to the city council and mayor under the Home Rule Act.[33] The Constitution's district clause is seen as an absolute grant to Congress of legislative authority over the district.[34] Indeed, Congress's power to legislate under the district clause is plenary:

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[24]S. 1435, 93d Cong., 1st Sess. (1973). Various parts of the Home Rule Act are codified in titles 1 and 47 of the D.C. code. *See, e.g.*, D.C. Code sections 1-206.46, 47-304, 1-206.02, 1-203.02, 1-206.01, and 1-206.03.

[25]In addition to amending the BSA via the disapproval/joint resolution process during the 30-day review period, Congress could enact a federal statute that adopts the entire BSA with or without changes. Although Congress has not attempted this in connection with a BSA (it has with standalone bills related to politically sensitive issues in the district, such as gun control laws), Congress retains ultimate control over district legislation despite its delegation of some control to the city council through the Home Rule Act.

[26]The Home Rule Act broadly defines budget as "the entire request for appropriations or loan or spending authority for all activities of all departments or agencies of the District of Columbia financed from all existing, proposed, or anticipated resources, and shall include both operating and capital expenditures." D.C. Code section 1-201.03(15).

[27]*See, e.g.*, section 220 of D.C. Act 18-448, the Fiscal Year 2011 Budget Request Act of 2010, as added by D.C. Act 18-657, the Fiscal Year 2011 Revised Budget Request Act of 2010 (unsuccessfully seeking to impose tax on nonresident athletes and entertainers).

[28]For a discussion of the Budget Request Act process, see *Hessey v. District of Columbia Bd. of Elections and Ethics*, 601 A.2d 3 (D.C. 1991).

[29]31 U.S.C. sections 1101(1) and 1105.

[30]D.C. Code sections 1-2.4.46, 1-206.03(a), and 1-206.02(a).

[31]*See* D.C. Code section 1-204.46.

[32]The district clause, U.S. Const. Art. I, section 8, cl. 17, grants Congress the power "to exercise exclusive Legislation in all Cases whatsoever, over such District (not exceeding ten Miles square) as may, by Cession of particular States, and the Acceptance of Congress, become the Seat of the Government of the United States, and to exercise like Authority over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards, and other needful Buildings."

[33]*See* D.C. Code section 1-206.01 (reserving the entirety of congressional constitutional authority over the district despite any provision of the Home Rule Act). Historically, district laws enacted by Congress before the Home Rule Act are not subject to limitations imposed on state laws. *McShain v. District of Columbia*, 205 F.2d 882 (D.C. Cir. 1953), *cert. denied*, 346 U.S. 900 (1953); *see also M.A.P. v. Ryan*, 285 A.2d 310, 312 (D.C. 1971) (D.C. Court of Appeals not bound by U.S. Court of Appeals decisions after 1971).

[34]*Palmore v. United States*, 411 U.S. 389, 397-398 (1886) ("It is apparent that the power of Congress under Clause 17 permits it to legislate for the District in a manner with respect to subjects that would exceed its powers, or at least would be very unusual, in the context of national legislation enacted under other powers delegated to it under Art. I, section 8").

> Congress possesses not only every appropriate national power, but, in addition, all the powers of legislation which may be exercised by a state in dealing with its affairs, so long as other provisions of the Constitution are not infringed.[35]

Federal and district cases have held that the district's legislation enacted by the city council, subject to the 30-day review process, is subject to dormant commerce clause limitations. More specifically, district laws enacted by the city council under the Home Rule Act — such as laws enacted through the BSA — are subject to dormant commerce clause limitations because courts historically have treated such district laws as if they were state legislation.[36] For example, long-distance telephone carriers mounted a successful dormant commerce clause challenge against the district's Gross Receipts Tax Amendment Act of 1987.[37] The District of Columbia Court of Appeals held that although the city council had authority to enact the 1987 act, the gross receipts tax violated the dormant commerce clause because it was internally inconsistent in violation of the fair apportionment prong of the *Complete Auto* test.[38] When Congress under its district clause power delegates legislative authority to the city council so that the council might function in a statelike manner, district laws such as the 1987 act are subject to the dormant commerce clause limitations to tax.[39] Thus, because the BSA is legislated by the district through its district clause power, it is subject to dormant commerce clause limitations.

In contrast to "local" district legislation, tax laws affecting the district and enacted by Congress in its capacity as a national legislature — such as the BRA — are not subject to the dormant commerce clause limitations to tax.[40] For example, in discussing a tax statute enacted by Congress in 1942, the district's court of appeals rejected the taxpayer's dormant commerce clause challenge:

> The statute therefore cannot offend the dormant commerce clause no matter what it says. While the dormant commerce clause may prohibit state legislatures and other non-federal legislative bodies from enacting burdens on interstate commerce, that clause imposes no limitations on Congress, even when Congress acts "like a state legislature" in exercising its plenary power to legislate for the District of Columbia under art. I, section 8, cl. 17 of the Constitution.[41]

Thus, "Congress, when acting as a local legislature for the district, (1) may have greater powers than Congress can exercise over the nation as a whole . . . but (2) may not contravene constitutional limitations applicable to Congress acting as congress."[42]

Where Do We Go From Here?

For those interested in the hotly debated subject of sales and use tax nexus standards, it will be important to monitor the progress of the District of Columbia Main Street Tax Fairness Act's progress as incorporated within the BRA and BSA. We believe

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[35] *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427 (1932) citing *Capital Traction Co. v. Hof*, 147 U.S. 1, 5 (1899) (discussing the applicability of the Seventh Amendment to the district).

[36] *See, e.g.*, *Pharmaceutical Research and Manufacturers of America v. District of Columbia*, 406 F. Supp. 2d 56 (D.C. Dist. 2005) (holding a district statute that was enacted by the council under the 30-day review period was per se invalid under the commerce clause because it regulated transactions occurring wholly outside the district); *Electrolert Corp. v. Barry*, 737 F.2d 110 (D.C. App. 1984) (applying dormant commerce clause analysis to a 1981 ordinance banning the possession of radar detectors); *Stoutenburgh v. Hennick*, 129 U.S. 141 (1889) (a local license tax enacted by the Legislative Assembly of the district impermissibly regulated interstate commerce, a power solely of Congress that it could not have delegated to the local district government).

[37] *Sprint Communications Co. v. District of Columbia*, 642 A.2d 106 (D.C. 1994). The 1987 act was stand-alone district legislation (Bill No. 7-186), enacted under the Home Rule Act. The long-distance carriers alleged the 1987 act violated the dormant commerce clause because of the limited exemptions for personal property tax and sales and use taxes discriminated against out-of-state-carriers. The 1987 act, in part, provided for personal property tax and sales and use tax exemptions for property in the district that generated gross receipts subject to the gross receipts tax at issue in the 1987 act. (For the decision, see *Doc 94-50531* or *94 STN 65-3*.)

[38] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

[39] *Milton S. Kronheim & Co. v. District of Columbia*, 91 F.3d 193, 201 (D.C. Cir. 1996).

[40] Congress, when acting as the legislature for the district, remains subject to constitutional restrictions imposed on the federal government, such as the Bill of Rights; *see, e.g., Capital Traction Co. v. Hof*, 147 U.S. 1, 5 (1899) (discussing the applicability of the Seventh Amendment to the district).

[41] *District of Columbia v. Helen Dwight Reid Educational Foundation*, 766 A.2d 28, 37 (D.C. 2001), *citing Neild v. District of Columbia*, 71 App. D.C. 306, 310-311, 110 F.2d 246, 250-251 (1940) (holding that the commerce clause constitutes no bar to congressional enactment of a gross receipts tax for the district); *see also Itel Corp. v. District of Columbia*, 448 A.2d 261, 263 (D.C. 1982) ("there are not two Congresses, one acting as the national legislature and another serving as the District legislature. An act of Congress, although local in scope, is nevertheless not analogous to a state law enacted by an independent legislature."). *Cf. Milton S. Kronheim & Co., Inc. v. District of Columbia*, 319 U.S. App. D.C. 389, 394-397, 91 F.3d 193, 198-201 (1996) (although restrictions of dormant commerce clause do not apply to laws enacted by Congress, they do apply to laws promulgated by the District of Columbia Council)."

[42] *District of Columbia v. American Federation of Government Employees,* 619 A.2d 77, 83-84 (D.C. 1993).

that Congress should not undermine the SSUTA's important achievements and the streamlined states' quest for true simplification and uniformity. Allowing the district to unilaterally adopt "Streamlined light" would reward the district and discourage greater participation within the SSUTA. In sum, 24 states have spent 11 years working to simplify their sales and use tax rules to conform to the SSUTA. Allowing the district to benefit from remote vendor nexus legislation that contradicts the national standard for sales and use tax collection of every other state cannot be the solution. ☆

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