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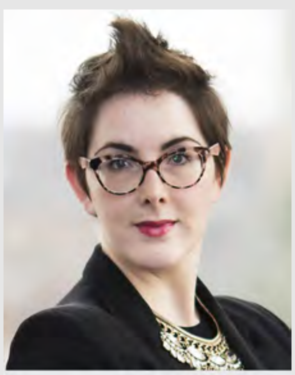

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In this installment of Eyes on E-Commerce, the authors discuss *Wayfair* and several serious consequences that have materialized since the landmark ruling two years ago.

In overruling over 50 years of settled precedent, the U.S. Supreme Court's opinion in *South Dakota v. Wayfair Inc.*[1] unleashed chaos in the marketplace. The ruling forced countless businesses to wrestle with the Herculean task of complying with a confusing and conflicting patchwork of state and local sales and use tax laws. The Supreme Court's use of the blunt instrument of reversal in a matter fraught with the kinds of complexities that require legislative balancing of competing public interests has also caused a number of unintended ripple effects.[2] Unable to bear either the costs or uncertainties, some businesses, including long-standing family-owned companies, have closed. As we approach the two-year anniversary of *Wayfair*, we have seen materialize several serious consequences, many of which were unanticipated by the small and medium-size businesses confronted for the first time with nationwide sales and use tax and other state tax compliance obligations.

First, we have witnessed the rise of "home rule" local jurisdictions — including cities and towns — vastly extending their municipal reach by going after nonresident sellers across the country for *local* sales and use taxes. These

[1] 138 S. Ct. 2080 (2018).

[2] A prior article (George S. Isaacson and David W. Bertoni, "The Strange Death of *Stare Decisis*" *State Tax Notes*, Sept. 3, 2018, p. 963) pointed to another source of chaos in the wake of *Wayfair*: Supreme Court willing to toss out long-standing precedent, both within and without the tax arena, without adequately considering or protecting against the damage such reversals can do to the legal system and the settled expectation of businesses and individuals. Indeed, a dissent from a denial of certiorari in the case of *Baldwin v. United States*, 2020 WL 871675, *1 (Feb. 24, 2020), pointed to *Wayfair* in urging the Court to throw out its long-standing rule in *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837, 844 (1984), which requires courts to adopt an agency's interpretation of an ambiguous statute (the IRS in *Baldwin*) as long as it is "reasonable." Justice Thomas invoked his concurring opinion in *Wayfair* that "it is never too late to 'surrende[r] former views for a better considered position.'" 138 S. Ct. at 2100 (quoting *McGrath v. Kristensen*, 340 U.S. 162, 178 (1950) (Jackson, J., concurring)). We fully expect *Wayfair* to be invoked as a rationale for revisiting many "established" rules in the tax arena.

jurisdictions operate independently of state tax authorities, each with their own audits, filing requirements, and protest procedures. They also have their own substantive and procedural tax laws, usually in the form of local ordinances, that can differ from the tax base and exemptions that are part of their own state's laws, and they are free to depart from the forms used by the state tax agency and even the decisions made by state auditors. For example, the state's tax department might agree that a sale is nontaxable, but a home rule jurisdiction can ignore that conclusion and find the opposite. If the latter occurs, the clock may start ticking on a protest deadline that is buried in municipal ordinances. As explained below, it is a recipe for conflict and chaos, which goes directly against the grain of *Wayfair*.

Second, we have witnessed states seeking to expand their authority to impose state income taxes based on *Wayfair*. But, as discussed below, these aggressive efforts are based on a misapprehension of what *Wayfair* really means, with the states using it, unfairly, as a cudgel to attack the federal protections set forth in Public Law 86-272 and failing, in some instances, to follow their own state statutes or engage in lawful rulemaking to create new, enforceable standards. If your lawyers or accountants miss a state's "informal bulletin" announcing such an abrupt change, your first notice may be an audit demand or a tax assessment.

Third, we have seen increased activity in the area of private class action lawsuits (asserting harm to the class from the overcollection of taxes) and *qui tam* lawsuits (asserting, ostensibly on behalf of the state or locality, harm from the undercollection of taxes) targeting retailers for tax refunds, penalties, and attorney fees. We have written several columns[3] on such lawsuits, which present a very real risk for businesses trying to navigate the complex sales and use tax systems of states across the country and impose a terrible cost of high stakes litigation in a remote, unfamiliar jurisdiction. We will bring you up to speed on recent developments in this area.

Before turning to these three risk areas, it's important to set the table with a brief discussion of *Wayfair* and its core principles.[4]

Wayfair, Briefly

It seems like a lifetime since the Supreme Court issued its precedent-smashing decision in *Wayfair* on June 21, 2018. Elimination of the bright-line physical presence test governing the power to tax nonresident businesses was an outcome championed by most states, which collectively assured the world that a favorable decision would be accepted with regulatory humility and a spirit of fairness, and not as a license for tax department overreach. Indeed, the main theme they echoed in the press, court filings, and testimony before Congress was a desire for fairness, a level playing field in which all retailers, local or remote, would be subject to the same burdens. It was a Utopian vision, and, as with all such visions, it crashed headlong into reality soon after the *Wayfair* opinion was published.[5]

Retailers, mostly new to nationwide state tax collection obligations, were left to scratch their heads about whether each individual state's effort to apply *Wayfair* resulted in an "undue burden" on interstate commerce, with little guidance from the Court. For example, the Court noted that South Dakota's sales tax scheme embodied elements that augured against a finding of an undue burden, including a safe

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[3] We previously addressed these risks in Eyes on E-Commerce columns: Bertoni and David Swetnam-Burland, "Storming the Castle: *Qui Tam* After Sprint's $330M Settlement," *Tax Notes State*, Mar. 11, 2019, p. 835; and Bertoni and Swetnam-Burland, "Barbarians at the Gates: Private State Tax Enforcement," *State Tax Notes*, Nov. 21, 2016, p. 585.

[4] On March 3, 2020, the House Small Business Committee on Economic Growth, Tax, and Capital Access was scheduled to hold a hearing to address the aftermath of *Wayfair*. Federal legislation is needed, given that Congress holds the power to step in and bring order to the turmoil caused by the Supreme Court's holding. The demand for federal legislation is not coming from the business community alone. Both chambers of the Arizona Legislature recently passed resolutions by unanimous votes pressing Congress to pass federal legislation to create a uniform and streamlined structure for assessing and collecting sales and use tax in light of the *Wayfair* opinion. *See* H.C.M. 2006 (Ariz. House of Rep. Feb. 19, 2020); and S.C.M. 1003 (Ariz. Sen. Feb. 13, 2020).

[5] As we discussed in a prior Eyes on E-Commerce column (Martin I. Eisenstein and Swetnam-Burland, "Chaos Theory: The States' Response to *Wayfair*," *State Tax Notes*, June 10, 2019, p. 887) the state response to *Wayfair* was to push the envelope to the very edge of the states' power to tax. The ink was not even dry on the opinion when some states announced that companies without a physical presence would be obligated to collect and remit taxes retroactively to within days of when *Wayfair* was decided, giving retailers no time to adjust to the new commerce clause reality. Other states were slightly more forgiving, allowing companies until October 1, 2018, a mere four months, to figure out and implement a program for tax compliance in far-flung jurisdictions.

harbor to protect small businesses; no retroactive application; and membership in the Streamlined Sales and Use Tax Agreement, which resulted in some degree of uniformity among its 24 signatory states, including single, state-level tax administration and uniform definitions of what is taxable. Numerous states that have jumped on the *Wayfair* bandwagon, including the largest tax jurisdictions in the United States, are not members of the SSUTA, however, and have undertaken few, if any, efforts to achieve uniformity with their sister states. Indeed, those with independent home rule cities and towns lack even the in-state uniformity required under the SSUTA.

To navigate this vast Sargasso Sea of potential tax entanglements, it is important to understand what *Wayfair* did and did not do when it rejected the bright-line physical presence test for establishing whether a state has the power to tax remote sellers:

- The Court replaced the physical presence test with an amorphous "undue burden" analysis. Thus, instead of battling over the bright-line test of whether a company has a physical presence in a particular state, the question now is whether imposition of a tax on a nonresident seller by one state or locality results in an undue burden on interstate commerce as part of a dense patchwork of inconsistent laws and obligations at the state and local levels across the entire country.
- The Court explained that this new undue burden analysis could include "internal" factors, that is, the complexity of a state's own tax system, taking into account both statewide and local taxes and compensation provided to retailers for collecting the state's tax; and "external" factors, that is, whether the state has taken steps to coordinate with other states for the purpose of enhancing the uniformity of their tax laws with other jurisdictions.[6]
- *Wayfair* did *not* address the interpretation of, and protections granted by, P.L. 86-272, the federal statute governing state taxation of net income. That statute offers strong protections, which, as explained below, states may be seeking to sidestep by invoking *Wayfair*.

Against this backcloth, we address *three* of the serious consequences of *Wayfair* that taxpayers are facing.

Attack of the Home Rule Jurisdictions

Businesses of all sizes are now increasingly likely to receive notices, audit demands, and assessments from home rule local tax jurisdictions. We addressed this issue in some detail in our prior Eyes on E-Commerce column.[7]

Briefly stated, home rule jurisdictions operate independently of the states in which they are located, conducting their own audits and issuing their own assessments, either independently of other home rule jurisdictions in the state or acting in concert with them. They can have:

- rules that differ from those at the state level regarding the reach of their tax powers, including definitions, exemptions, and exclusions so that what is not taxable at the state level and in some home rule jurisdictions may be taxable in other home rule jurisdictions in the same state;
- separate reporting and filing obligations;
- separate and independent audits; and
- different tax protest procedures to challenge assessments.

[6]Regarding "external" factors, the Court pointed to South Dakota's participation in the SSUTA, which creates a degree of uniformity among member states in a variety of ways that could be seen as reducing the burden for remote sellers required to collect and remit sales and use taxes in the states that are members. To the extent a state is not a member, which is the case for states accounting for about two-thirds of the U.S. population, the external factor is not satisfied. Despite the Court's decision, no new states have joined the SSUTA, and states that are not members of the SSUTA are still pressing forward to apply the *Wayfair* holding to remote sellers.

[7]Eisenstein and Bertoni, "*Wayfair* Misused: States and Cities Seek to Expand Their Tax Powers," *Tax Notes State*, Dec. 16, 2019, p. 891.

Home rule jurisdictions are also becoming increasingly aggressive, and taxpayers are being forced in greater numbers to confront the costly burdens they seek to impose and determine what defenses they might have.

The problems arising from home rule local taxes were not directly addressed in *Wayfair* because local taxes in South Dakota are handled *at the state level*. Indeed, the Court referred favorably to uniform state and local administration of the South Dakota law as a factor mitigating the burden of tax collection. In contrast, home rule local jurisdictions — cities, counties, and parishes — handle their affairs independently of the state. Home rule jurisdictions exemplify the withering complexity that led the Court in *National Bellas Hess v. Department of Revenue*,[8] and *Quill Corp. v. North Dakota*[9] to establish and uphold the bright-line physical presence test for tax jurisdiction.

Now, under *Wayfair*'s amorphous undue burden analysis, taxpayers are left to wonder whether, once they have registered to collect and remit state sales and use taxes, they must now contend with the mind-numbing complexities and risks of home rule jurisdictions as well when the amount at issue in any one home rule jurisdiction may be small yet the litigation costs of establishing undue burden may be enormous. In other words, the expense of litigation, not the legal merits, may determine whether a business registers in and collects taxes on behalf of a home rule jurisdiction. As home rule jurisdictions increasingly awaken to the possibility of imposing their taxes on remote sellers, more and more companies are faced with demands for tax collection from places like Castle Pines, Colorado, and Nome, Alaska. There are no easy answers to dealing with such demands. Many of the legal issues they raise are novel and have yet to be addressed by administrative tribunals and the courts, all of which creates a Hobson's choice whether to collect the home rule jurisdiction's tax or fund the expense of litigation through local and state tribunals, which may have little sympathy for the plight of companies located in other states.

[8]386 U.S. 753 (1967).

[9]504 U.S. 298 (1992).

Nevertheless, taxpayers *do* have lines of defense against aggressive home rule jurisdictions. For example, as explained earlier, the Supreme Court in *Wayfair* highlighted features of the South Dakota sales and use tax system that it deemed critical in protecting against an undue burden on retailers. One of these important features was that, as a result of the requirements of membership in the SSUTA, tax administration for the state and local jurisdictions within the state was consolidated into a single, state-level tax authority. When home rule cities and other municipalities levy and administer their own separate taxes on a retailer, the already substantial burden of tax collection throughout the 45 states and the District of Columbia multiplies exponentially.[10]

Alabama, Alaska, Arizona, Colorado, Idaho, and Louisiana each have independent home rule local jurisdictions that administer sales taxes, but they have responded differently to *Wayfair*. States like Alabama, Arizona, and Idaho got the *Wayfair* message that only a single, state-level tax authority should administer state taxes. Idaho, for example, *prohibits* remote retailers from collecting and remitting local sales taxes.[11] Alabama has not only created a single system for the collection and remittance of state and local sales and use taxes, but also allowed remote sellers to elect to collect at a single, flat tax rate.[12] Arizona, which had consolidated administration of local transaction privilege taxes up at the state level several years ago, eliminated the requirement that remote sellers register with local jurisdictions.[13] Louisiana previously required out-of-state retailers to jump

[10]As of this writing, all but two states with sales and use taxes — Florida and Missouri — have adopted economic nexus laws; and both Florida and Missouri have pending legislation to enact such laws.

[11]Of course, simply having internal uniformity does not address the larger question whether a state or home rule jurisdiction must be part of a larger, interstate program of uniformity, such as the SSUTA, to defeat a commerce clause challenge under the new *Wayfair* rules. We expect that this issue will be addressed in due course by state tax agencies and the courts. It is unclear what standard will ultimately be applied to determine whether an "undue burden," in fact, exists under the commerce clause, and if past is prologue, it is possible that different state courts will establish different standards unless and until the U.S. Supreme Court revisits a case presenting this issue. In *Wayfair*, the Court remanded the case to the lower courts to determine if an undue burden on interstate commerce existed, and the case was resolved before the lower courts had an opportunity to address the issue.

[12]*See* Ala. Code sections 40-23-240 to 244 (establishing the ONE SPOT system).

[13]Ariz. H.B. 2757.

through hoops, making them register, report, and remit separately with the state and the multitude of parishes. The state has since established a centralized commission with the goal of central administration of all applicable state and parish taxes, but the details remain to be worked out.[14] While not entirely eliminating the burden on remote sellers, the measures taken by these states go a long way toward ensuring the burden is not undue.

Unfortunately, the same cannot be said of Colorado or Alaska. Some of Colorado's home rule cities have gone on the offensive, sending letters to remote sellers announcing their intent to enforce remote seller nexus. Castle Pines, a new home rule city and the first to explicitly adopt remote seller nexus, took things one step further by involuntarily registering remote sellers in anticipation of enforcing its new ordinance. Even though its tax system differs from the state's tax system, ironically the threshold of sales to require tax collection in Castle Pines is based on a company's *statewide* sales regardless of the retailer's sales in the individual home rule jurisdiction.[15]

We should note that Colorado's 78 home rule jurisdictions are considering banding together to create a centralized registration portal modeled on Louisiana's old system — essentially a website for centralized registration, but without the uniformity of tax base and rates either from jurisdiction to jurisdiction or with the state itself. We are skeptical whether that will provide the kind of simplification called for by *Wayfair*.

Alaska, which has no statewide sales and use tax, is heading down the same path as Colorado. Claiming a system modeled on the SSUTA, 29 of the more than 100 municipalities in the state entered into an agreement late in 2019.[16] The agreement created the Alaska Remote Seller Sales Tax Commission, and provided a model code through which remote seller "nexus" will be adopted by all signatories. Like Castle Pines, the small-seller economic nexus threshold adopted in the commission's model code is based on *statewide* sales of $100,000 or 200 transactions.[17] Although the agreement offers centralized registration and payment at the commission level, and makes free geographic information system mapping software available, it offers little else. Retailers will be required to undertake a separate evaluation for each of the 29 current member municipalities to determine:

- whether their products or services are subject to tax;
- what is the applicable tax rate for that product or service; and
- what is the appropriate certificate needed to document any applicable exemption.

As if that undertaking were not burdensome enough, just knowing in which of the 29 member municipalities a retailer is required to collect is its own quagmire. The starting point for collection and in which municipalities to collect are unclear. Under both the Intergovernmental Agreement and the model code, remote sellers are not required to register, collect, and remit in a municipality until the municipality passes an ordinance adopting the Uniform Tax Code.[18] Even then, remote sellers have 30 days from the date the municipality passes the ordinance in which to register.[19] The way the centralized registration module adopted by the commission works now, however, directly contradicts the agreement and code. In a notice to remote sellers, the commission encouraged *immediate* registration.[20] Because remote sellers register with the commission and not with individual member municipalities, municipalities that have passed the required ordinance appear as if by magic in the registered seller's account — the obligation to collect in that municipality becomes automatically effective. Once in the account, sellers are required to report sales to that municipality and make payment of taxes due on those sales *whether or not collected* from their customers, and in direct contradiction

[14] La. H.B. 547.

[15] Castle Pines Ord. section 19-13, "Doing Business in This City."

[16] The Alaska Remote Sellers Sales Tax Commission Intergovernmental Agreement.

[17] Alaska Remote Sellers Sales Tax Model Code section 040.

[18] ARSSTC Intergovernmental Agreement, Article V.2. As of this writing, Juneau stands as the lone municipality that has adopted the Uniform Tax Code by ordinance.

[19] *See* ARSST Intergovernmental Agreement, Article VI.1.c.; and ARSST Uniform Code section 070.B. If needed, remote sellers can request up to 90 days to register. Uniform Code section 070.C.

[20] ARSSTC Notice to Remote Sellers.

to the very terms of the Uniform Tax Code. As it stands, the commission has no plans to provide remote sellers advance notice of the municipalities that pass such an ordinance. Registration is, then, a fool's errand.

Among the questions that remain unanswered is whether a statewide threshold for sales numbers or sales volumes, of the kind instituted in South Dakota, suffices to give local home rule jurisdictions the ability to piggyback on the authority of the state to impose taxes. If not, at what level must a company do business with consumers in a home rule jurisdiction before the jurisdiction's power to tax that business can attach? For example, one home rule jurisdiction — Crested Butte, Colorado — has claimed the authority to tax if a company causes merely one delivery to be made into the jurisdiction.

The Threat of State Income Taxes

Also addressed in "*Wayfair* Misused: States and Cities Seek to Expand Their Tax Powers"[21] is the increasing risk of companies finding, much to their surprise and consternation, that their registration for sale and use tax compliance has opened them up to demands for state income taxes, gross receipts taxes,[22] and even escheat.[23] Companies may also conclude, based on aggressive statements by individual states, as well as a working group of the Multistate Tax Commission convened to consider revisions to the MTC's Statement of Information Concerning Practices of Multistate Tax Commission Signatory States Under P.L. 86-272 (MTC Statement of Information),[24] that all is lost and that *Wayfair* has given the states a free pass to impose income taxes on every remote seller that meets some minimum sales threshold for sales to in-state consumers. The *Wayfair* decision, however, did nothing to alter the standard for imposition of income taxes, nor did it eliminate protections from these taxes available to companies engaged in interstate commerce. Despite the MTC's draconian pronouncements, remote sellers have protections in the area of income taxes that are far more robust than those available in the case of sales and use taxes. Chief among these is P.L. 86-272, which sharply limits the power of a state to impose income taxes on companies that lack required activities within the state.

Indeed, under the mantra of bringing P.L. 86-272 into the modern era, the working group of the MTC has lost sight of the fundamental purpose of this federal statute and the protection it provides. Under the most recent draft of its guidance, any online retailer that has a modern website effectively loses the protection of P.L. 86-272. In the words of the MTC's working draft: "As a general rule, when a business interacts with a customer via the business's website or app, the business engages in an activity within the customer's state."[25] The draft statement now considers such features as customer service online chat, applications for branded credit cards, online job applications, some internet cookies, and streaming services to be unprotected. If this draft is adopted by the MTC and states, modern online retailers with user-friendly websites would be exposed to income tax liability in those states, absent an administrative and court challenge. The working group claims that it is guided by the idea that the sovereign authority of states to impose taxes will not be preempted absent Congress's clear and manifest purpose. But that *is* what P.L. 86-272 represents: an affirmative act of Congress under its commerce clause powers to protect retailers from the long arm of the state.

At a high level, P.L. 86-272 creates a zone of protection even for a company that has an in-state presence, provided that presence is limited to the solicitation of sales for tangible personal property and activities ancillary to such solicitation. This statute expressly provides that "no state, or

[21] *Supra* note 7.

[22] Ohio has begun commercial activity tax audits of companies that registered for sales tax collection but have yet to pay the Ohio commercial activity tax.

[23] The New York comptroller's Office of Unclaimed Funds, which administers the New York escheat law, has sent letters to several retailers that registered for sales tax purposes to notify them of their obligations to remit to the state uncashed checks and unredeemed gift cards and gift certificates.

[24] In November 2018 the MTC's Uniformity Committee agreed to form a work group to update the MTC Statement of Information, a statement originally adopted in 1986 and last revised in 2001. At a February 20, 2020, meeting the work group approved a draft update to the MTC statement. The revised statement is expected to be presented to the Uniformity Committee at the MTC's April meetings, and the committee will then decide whether to recommend its adoption by the MTC's Executive Committee.

[25] MTC Statement of Information Section IV.C., "Activities Conducted via the Internet."

political subdivision thereof, shall have the power to impose . . . a net income tax" on a nonresident "if the only business activities within such state by or on behalf of such a person during the taxable year" are limited to solicitation of sales of tangible personal property. Indeed, the statute could not be clearer in this regard. Thus, unless (1) a company has presence "within the state" and (2) such a presence goes beyond the zone of protection for solicitation of sales of tangible personal property, P.L. 86-272 provides immunity from state and local net income taxes.

And what does *Wayfair* have to do with the analysis and interpretation of P.L. 86-272? Absolutely nothing. *Wayfair*, as we have previously explained, deals with the constraints of the dormant commerce clause, not the interpretation of a federal statute, P.L. 86-272, enacted in 1959. The most compelling reading of the statute, based on canons of statutory interpretation confirmed by the U.S. Supreme Court on the same day *Wayfair* was decided, is that exceeding the limits of P.L. 86-272, and thus forsaking its protections, requires the out-of-state company or its representatives to conduct activities in the taxing state.[26] *Wisconsin Central* makes clear that the words of a tax statute enacted in the 1950s must have the meaning that was intended when it was enacted, and not be given some gloss that rests on a radically different economy and modalities of commerce that came into existence many decades later. Modern theories of a virtual internet presence cannot inform how P.L. 86-272 is either interpreted or applied.

The Brave New World of *Qui Tam* and Class Actions

Along with having to collect and remit taxes in numerous jurisdictions, the brave new world of *Wayfair* has exposed many companies to the growing challenge of private litigation over state tax disputes. Until now, these actions targeted larger retailers. Moreover, the only retailers that had to worry were those that, under the clear bright-line test of *Quill*, were required to collect and remit taxes in the jurisdictions that permitted such lawsuits. *Wayfair*, with its expanded obligations on small and medium-size companies, now exposes a wide array of companies to the perils of these privately brought claims, and the risk of onerous penalties — as high as three times the amount of the taxes in question — and class action damages awards. While these risks have been present for some time, they are rising and will likely confront, unexpectedly, the larger universe of companies that *Wayfair* compelled into nationwide tax collection.

False Claims Act Lawsuits

In the memorable words of Yogi Berra, it's déjà vu all over again. While the Yankees catcher cannot have had state false claims act litigation in mind when he coined this memorable phrase, it could not be more applicable to the current state of play at the intersection of state tax compliance and state false claims act liability. The risk is real and may be growing. These lawsuits, also known as *qui tam* actions, are brought by private parties on behalf of a state, essentially asserting that a retailer has *failed in its obligation to collect taxes*. The risks of such a suit extend not only to companies that have failed to register and collect taxes at all, but to those that, once registered, have failed to collect enough taxes. As discussed below, *qui tam* suits have been brought against companies for the claimed failure to collect taxes on just one component of a transaction, that is, shipping and handling charges. Such lawsuits generally provide not only for the recovery of any uncollected taxes *on behalf of the state*, but also penalties above and beyond any proven tax liability, including treble damages. They, in essence, create a roving band of private attorneys looking to capitalize on perceived tax undercollection, and it is likely we will see an increase in actions against companies that have not registered for state tax collection or fail to collect, for example, local taxes — especially if new jurisdictions, including California, authorize such lawsuits.

First, a quick refresher. The federal False Claims Act is a Civil War-era statute designed to combat fraud on the government by offering a bounty to whistleblowers who come forward with

[26] *Wisconsin Central Ltd. v. United States*, 138 S. Ct. 2080 (2018).

evidence of otherwise hidden fraud or corruption.[27] Twenty-nine states and the District of Columbia have enacted state false claims acts modeled on the federal original.[28] Under these statutes, a private whistleblower (often referred to as a relator) can file a *qui tam* lawsuit (on behalf of the federal or state government and, if successful, receive a percentage of any civil penalties, *treble* damages, and attorney fees).[29] In exchange for unveiling hidden fraud, the relator receives a cut. Importantly, the federal act does *not* permit a whistleblower to bring a false claims act lawsuit for alleged tax fraud.[30] Most of these statutes mirror the federal act in excluding lawsuits based on tax fraud from the scope of their false claims acts.

Two states, however, remain the exception to this rule. Illinois and New York both permit "whistleblowers" to bring lawsuits on behalf of the state based on allegations of "tax fraud." The Illinois legislature excluded only state income tax matters from the scope of its false claims act.[31] The result has been hundreds of lawsuits filed by a private plaintiffs' law firms (acting as both client and counsel) on behalf of the state alleging that retailers *undercollected* Illinois retailers' occupation or use tax, whether because of an alleged failure to register with the state or for allegedly failing to collect tax on, for example, shipping and handling charges.[32]

New York took an even bolder approach, expressly amending its false claims statute to permit tax-based fraud claims.[33] This amendment has led to some jaw-dropping results. In August 2018 the New York attorney general and tax commissioner announced a criminal conviction and false claims act settlement with Spa Castle Inc. regarding a claim of tax fraud, which included a $2.5 million payment.[34] In December 2018 the New York attorney general and tax commissioner announced a $330 million settlement with Sprint in false claims act litigation involving unpaid sales tax.[35] And in November 2019 the state attorney general announced that it had filed suit against B&H Foto & Electronics Corp. under the state false claims act for the alleged failure to pay sales tax on tens of millions of dollars it received from electronics manufacturers in reimbursements for instant rebates.[36]

At least two jurisdictions may be poised to line up behind New York. In California, Assembly member Mark Stone (D) has once again introduced a bill, A.B. 2570, that would expand that state's false claims act to include claims of tax fraud, and he has the support of California Attorney General Xavier Becerra. If enacted, the change would go into effect in January 2021. The prospect of private litigation of tax disputes in the nation's most populous state is chilling. Brian Hamer, counsel with the MTC who had direct engagement with this kind of litigation during his time as director of the Illinois Department of Revenue, noted the "troubling public policy issues" raised by "a privatization of tax enforcement" in discussing a similar bill proposed in 2019.[37]

The District of Columbia is considering legislation that would reach the same result.[38]

In this post-*Wayfair* world, these bills bear close watching. It is challenging enough to

[27] *See* 31 U.S.C. sections 3729-33; *U.S. ex rel. Mathews v. Bank of Farmington*, 166 F.3d 853, 857-58 (7th Cir. 1999).

[28] *See* Office of the Inspector General, "State False Claim Act Reviews" (listing state false claims acts); and Office of the Attorney General for D.C., "PL False Claims Act."

[29] *See* 31 U.S.C. section 3730.

[30] *See* 31 U.S.C. section 3729(d).

[31] *See* 740 ILCS 175/3(c).

[32] In the interest of full disclosure, we have represented several defendants in these Illinois cases, including one that prevailed at trial and on appeal. *See State of Illinois ex rel. Schad, Diamond & Shedden P.C. v. National Business Furniture LLC*, 2016 IL App (1st) 150526 (Aug. 1, 2016).

[33] *See* N.Y. Fin. Law section 189(4).

[34] *See* New York State Office of the Attorney General, press release, "A.G. Underwood and Acting Tax Commissioner Manion Announce Criminal Conviction and False Claims Act Settlement With Spa Castle Inc. for Tax Fraud" (Aug. 23, 2018).

[35] *See* New York State Office of the Attorney General, press release, "A.G. Underwood and Acting Tax Commissioner Manion Announce Record $330 Million Settlement With Sprint in Groundbreaking False Claims Act Litigation Involving Unpaid Sales Tax" (Dec. 21, 2018).

[36] *See* New York State Office of the Attorney General, press release, "Attorney General Sues B&H Foto & Electronics for Defrauding New York Out of Millions in Sales Tax" (Nov. 14, 2019).

[37] Maria Koklanaris, "Extending FCA to Tax in Calif. May Open Litigation Floodgate," Law360 (Aug. 29, 2019).

[38] *See* B23-0035, the False Claims Amendment Act of 2019. This amendment mirrors proposals previously considered by the District in 2013, 2016, and 2017.

comply with the new registration and collection requirements of thousands of state and local jurisdictions. Adding the threat of treble damages, civil penalties, and attorney fees in lawsuits filed by private plaintiffs and their counsel — which, in Illinois, were one and the same — only increases the risk and stakes for businesses trying hard to do the right thing. Although evidence of good-faith efforts to comply should suffice to overcome a fraud claim under a state false claims act, the costs of litigation alone can drive businesses accused of tax fraud to settle even dubious claims. The introduction of self-interested private players into public tax collection systems is fraught with peril.

Class Action Lawsuits

The insidious bookend to *qui tam* actions is the class action lawsuit that attacks a business that allegedly overcollected state taxes. They operate like a tax refund claim on steroids, seeking to force companies to pay back to the "class" (a group of consumers potentially numbering in the thousands or more) allegedly overcollected taxes even if the company has already — as required — remitted those taxes to the state. Incongruities between retailer remedies for the recovery of remitted taxes and class action demands can often create situations in which a retailer may face the risk of double taxation — unable to obtain a refund from the state in question while also required to refund the tax to consumers.

The question of potential overcollection of taxes can arise in unexpected ways. For example, in some states, like Missouri, the interplay of state and local taxes can present traps for the unwary that can lead to tax collection nightmares. If, for example, a company collects the sales tax on a transaction to which the use tax applies, it can find itself on the receiving end of a class action by charging for a local sales tax. This results from a quirk of the complicated Missouri tax scheme under which some local jurisdictions that charge a sales tax do not have a use tax (or charge use tax at a different rate). But class actions are not limited to the dynamic between state and local taxes.

In *Holzum v. Walmart Stores*,[39] Walmart was sued on a class action basis for charging the full 4.225 percent state sales tax on some items that the plaintiff's lawyers argued ought to have been taxed at the rate of 1.225 percent for qualifying foods, that is, those bearing a "nutrition facts" label. This is the kind of mistake that might never be identified in a state tax audit, and for which the state itself might never complain. But with class action lawyers prowling the internet for potential cases, a potential mistake like this — even if innocently made — could lead to a costly class action lawsuit, with the potential for an award of attorney fees to the plaintiffs' lawyers.

In *Holzum*, Walmart, in an unsuccessful effort to keep the case in federal court, brought to the court's attention an attorney fee award in Missouri of over $6 million in a class action in which $125,261 in damages was awarded — offering proof positive of just how economically devastating tax enforcement by class action can be because of the potential for having to pay the plaintiffs' attorney fees. Moreover, in *Walmart*, the plaintiffs' lawyers also sought punitive damages against the company on the grounds that the mistake it allegedly made was reckless, an accusation that could lead to costly discovery on what the defendant knew and when it knew it. Although punitive damages are difficult to obtain, the sky literally can be the limit if the elements for liability are found by a jury.

Unlike the Missouri court in the *Walmart* case, some jurisdictions are less friendly to class action lawsuits concerning tax collection. For example, in *Togut v. Forever 21 Inc.*,[40] the court dismissed a class action on the basis that actions by consumers arising out of allegations of excess tax collection must be pursued through refund claims filed with the state tax agency. In *Togut*, the plaintiff's lawyer tried to sidestep this requirement by alleging that the defendant had failed to remit collected taxes to the state. While, if true, the allegation of non-remittance might have opened the door to a class action, the court concluded that the complaint's claim of non-remittance was too amorphous and speculative to be countenanced; plaintiff Laura

[39] No. 4:17-CV-2275 RLW (E.D. Mo. Aug. 10, 2018).

[40] 285 F. Supp.3d 643, 646 (S.D.N.Y. 2018).

Togut, the court observed, had failed to allege specific facts and documents to back up her summary claim. The court refused to permit discovery on the issue. The same conclusion was reached in *Guterman v. Costco Wholesale Corp.*,[41] a decision recently upheld by the U.S. Court of Appeals for the Second Circuit.[42] *Guterman* appears to have overruled other federal court decisions that permitted claims to proceed based on the allegation of a business's failure to remit taxes, including *Porsch v. LLR Inc.*[43]

Similarly, in *Webster v. LLR Inc.*,[44] a federal court refused to permit a national class action to proceed based on an alleged overcollection of taxes in 11 states in connection with clothing sales in a network of independent retailers across the United States that sold goods under an arrangement with LLR Inc., a direct-sales company. The court's decision rested, in part, on the fact that in several of those states refund claims lodged with the state were the exclusive remedy for claims of tax overcollection.[45]

The bottom line is that plaintiffs' lawyers will be pushing and prodding to find openings for class action lawsuits involving the alleged overcollection of sales and use taxes, whether at the state or local level. Given the inherent complexities of tax collection, including collecting at the right local tax rate to the extent there is not a matching of ZIP codes with the tax jurisdictions, there may be an increasing number of cases of overcollection. In addition to questions concerning whether the state's tax refund procedures constitute an exclusive remedy, taxpayers may also have other defenses such as a lack of standing and common law defenses (such as the voluntary payment doctrine) to defeat such measures. But mounting these defenses can come at a significant litigation cost, which plaintiffs' attorneys can use to increase the pressure to settle.

To avoid the pitfalls of class action litigation, businesses that sell goods or services online should not overlook the use of mandatory arbitration agreements in their terms and conditions for website purchases. Such clauses, if implemented appropriately, can require claims relating to an online purchase, including related tax claims, to be addressed individually in arbitration, rather than in high-risk litigation involving countless claimants assembled into a class. The U.S. Supreme Court has actively affirmed the "national policy favoring arbitration when the parties contract for that mode of dispute resolution" in its interpretation of the Federal Arbitration Act (FAA).[46] The FAA calls for the application in both federal *and* state courts of federal substantive law regarding arbitration.[47] Thus, "when parties agree to arbitrate all questions arising under a contract, state laws lodging primary jurisdiction in another forum, whether judicial or administrative, are superseded by the FAA."[48] In other words, a valid and binding arbitration clause ought to be enforced even if a state law purports to limit the availability of arbitration.

Enforcing *online* terms of use, however, can be tricky, particularly in seeking to terminate class actions in favor of arbitration. The ways in which the terms of use are presented, and the manner in which consumers express their consent to the terms, can be critical to the creation of an enforceable commitment to arbitrate disputes governed by those terms of use, including tax disputes. An effort to enforce such terms can fail, for example, if a website fails adequately to show that by placing an order or taking some other action, the consumer has clearly manifested an intent to be bound by those terms. In a recent case in Illinois, a federal court concluded that a consumer had *not* agreed to the terms of use because the website inadequately disclosed that by clicking a "continue" button, the consumer

[41] 342 F. Supp.3d 468, 480 (S.D.N.Y. 2018).

[42] 927 F.3d 67 (2d Cir. 2019).

[43] 380 F. Supp.3d 418, 427 (S.D.N.Y. 2019) (permitting claim when adequate allegations were made that an overcharge was presented "under the guise of a 'sales tax'" and never remitted to the state).

[44] No. 2:17CV225, 2018 WL 10230741, at *2 (W.D. Pa. Aug. 20, 2018).

[45] *See also McClain v. Sav-On Drugs*, 6 Cal. 5th 951, 435 P.3d 424, 425, *cert. denied sub nom. McClain v. California Department of Tax and Fee Admin.*, 140 S. Ct. 127, 205 L. Ed. 2d 39 (2019) (permitting a suit against a retailer only when "a prior legal determination" has established that that retailer has a right to a refund, but the retailer fails to seek one and to reimburse its customers from the proceeds).

[46] *Preston v. Ferrer*, 552 U.S. 346, 349 (2008).

[47] *Id.*

[48] *Id.* at 349-50.

was manifesting an agreement to the site's terms and conditions.[49]

In contrast, in three cases involving the retailer Wayfair, one involving a claim of overcollection of tax by Wayfair, the courts found that Wayfair's approach made it clear that by clicking the "place your order" button, consumers were clearly advised that such action constituted an acceptance of the website's terms of use, which included a mandatory arbitration clause.[50] Given the potential benefits of having a binding, valid arbitration provision, businesses should draft their terms of use with care and make it clear to consumers that by completing a transaction or taking some other action on the website, they are manifesting their assent to the website's terms of use.

Conclusion

The fears of many have come to pass in this chaotic post-*Wayfair* world. Remote localities have been emboldened to assert tax obligations against far-off businesses with no local ties beyond the occasional retail sale. States have taken aggressive positions regarding the applicability of economic nexus outside the sales and use tax context, treating *Wayfair* as not only a reversal of *Quill*, but also a repudiation of P.L. 86-272. Private plaintiffs' attorneys appear poised to pounce on any perceived mistake in compliance, whether through class actions for alleged overcollection or false claims act lawsuits for alleged undercollection. In all these scenarios, businesses are on the horns of a dilemma, forced to decide between putting up an expensive fight in a foreign jurisdiction or acquiescing to this kind of overreaching. Now more than ever, businesses must plan appropriately to avoid the legal mines *Wayfair* has left behind. ■

[49] *Anand v. Heath*, No. 19-CV-00016, 2019 WL 2716213 (N.D. Ill. June 28, 2019).

[50] *Rolufs v. Wayfair LLC*, Case No. 19SL-CC02114 (Nov. 18, 2019); *Gorner v. Wayfair Inc.*, No. 18 C 8259, 2019 WL 2409595 (N.D. Ill. June 7, 2019), *appeal dismissed*, No. 19-2276, 2019 WL 7486843 (7th Cir. July 30, 2019); and *Nicholas v. Wayfair Inc.*, 410 F. Supp.3d 448 (E.D.N.Y. 2019).