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Sales tax rule moves forward despite legislative ‘angst’

The administration’s out-of-state sales tax collection rule escaped from an uneasy Joint Government Operations Committee Thursday with no recommendation.

In the sometimes bizarre realm of rulemaking and legislative oversight, this constitutes an important victory for Gov. Bill Haslam. A negative recommendation, as proposed by House Democratic Caucus Chairman Mike Stewart (D-Nashville), would have dealt the governor a crushing defeat and probably killed the rule.

As it is, the rule will take effect Jan. 1, with collection and remittance required starting July 1 unless the full legislature intervenes. The rule declares that any out-of-state vendor with sales in Tennessee of at least \$500,000 a year is deemed to meet the standard for “substantial nexus,” the degree of connection to a state that is necessary, based on legal precedents, for mandatory collection and remittance of sales and use tax.

The administration lobbied the issue heavily in the days leading to the vote, with Haslam personally making calls the night before. Joining Finance Commissioner Larry Martin and Revenue Commissioner David Gerregano in making the case before the committee were state Attorney General Herbert Slatery, who defended its legal basis, and UT economist Bill Fox, who argued it’s in the state’s interest to treat businesses alike.

New look at Quill? In the 1992 decision in *Quill Corporation v. North Dakota*, the U.S. Supreme Court ruled that a state could not force a business that had no physical presence in the state to collect its sales tax unless Congress passed a law to allow it. This sparked the streamlined sales tax movement, intended to make such collections easier and encourage congressional action. But nearly a quarter-century later, Congress hasn’t acted.

In the meantime, what began as an interstate commerce issue concerning catalog companies has evolved into an Internet commerce issue with vastly greater implications. According to Fox, director of UT’s Boyd Center for Business and Economic Research, census data indicate American consumers made \$5.5 trillion in purchases over the Internet in 2014. There are no Tennessee-specific data, but generally the state accounts for

about 2% of economic activity, he said, which in this case would amount to \$110 billion.

In March 2015, in his concurrence in a relatively limited Colorado tax case, *Direct Marketing Association v. Brohl*, Justice Anthony Kennedy observed that *Quill* “now harms states to a degree far greater than could have been anticipated” when the “questionable” ruling was made. He said “an appropriate case” should be found “for this court to re-examine *Quill*.”

In Tennessee and other states, officials interpreted that as an invitation to force a court challenge. The Tennessee Department of Revenue proposed its rule in June and held a public hearing in August.

Litigation already is underway over similar steps in Alabama, where the sales threshold is \$250,000, and South Dakota, where the floor is \$100,000.

The nation’s largest online retailer, Amazon, does collect the Tennessee tax and has shipping centers in the state. And some online enterprises with no physical presence collect the tax voluntarily.

Last summer, revenue officials offered a rough estimate, largely based on a 2009 University of Tennessee study on uncollected sales tax, that the rule could generate \$350 million to \$500 million annually. At the public hearing, some opponents suggested that range was too high. Thursday, Steve Roth, general counsel for Jewelry Television in Knoxville, told the committee that when South Dakota sent letters to 206 out-of-state retailers, only 20% responded. Retailers, he said, “are not going to line up to pay this tax.”

Commissioner Gerregano, who took the helm of the revenue department this month, laid out a lower estimate than was first floated: \$160 million in state revenue and \$59 million in local revenue, or \$219 million in total new collections. The new estimate takes into account that companies making less than \$500,000 in Tennessee sales won’t be required to collect the tax. Sen. Janice Bowling (R-Tullahoma) remarked that the lower figure is “almost not worth the angst we’re going through.”

Fairness. Officials’ main pitch focused not on the tax revenues, but fairness to businesses and consumers and

a negative economic impact of not treating in-state and out-of-state retailers the same.

Regardless of whether the tax is collected, a Tennessee purchaser owes it under the law. The question is whether the seller collects it for the state. Brick-and-mortar businesses do, and some remote sellers do. The third category, those that do not, are able to offer consumers nearly a 10% saving by enabling evasion of the tax.

Fox argued that in allowing remote sellers not to collect the tax, the present system effectively levies a 9.5% tariff to do business in Tennessee and 0% to operate out of state. This discourages sellers from locating warehouses and hiring workers in Tennessee, he said. Moreover, purchasers aren't treated the same, as senior citizens, low-income persons, and rural residents are less likely to shop on the Internet and thus end up paying sales tax on their purchases while more affluent buyers often escape taxation.

In 2013, the U.S. Senate passed the Marketplace Fairness Act, sponsored by Sen. Lamar Alexander (R-Maryville) and supported by Sen. Bob Corker (R-Chatanooga). But it did not pass in the House, where U.S. Rep. Marsha Blackburn (R-Brentwood) and others have characterized the concept as a tax increase.

State legislators find themselves in a tough spot politically. Many are sympathetic to local businesses but also wary of being attacked in election campaigns for voting in favor of what opponents will label a new tax on the Internet. Some would rather not have to vote.

And most more or less didn't on Thursday. The Senate members and House members of the joint committee must take separate votes. After Stewart made his motion to give the bill a negative recommendation, no senator voted to do so. Two voted against the motion — Sens. Ed Jackson (R-Jackson) and Rusty Crowe (R-Johnson City). And four senators abstained: Sens. Kerry Roberts (R-Springfield), Mae Beavers (R-Mt. Juliet), Brian Kelsey (R-Germantown), and Bowling.

House Government Operations Chairman Jeremy Faison (R-Cosby) took a roll call vote, declared the motion defeated on the House side, and ruled the committee thus had made no recommendation.

This means the rule as promulgated will be part of the annual omnibus bill the legislature passes to approve new rules. An amendment to strip it out almost certainly will be proposed, so the fight isn't over.

Had the joint committee given the rule a negative recommendation, it would have been taken out of the bill, and affirmative action would have been required to add it as an amendment, requiring votes at multiple steps of the legislative process. Odds of success would not have been good.

Now, though a fight looms, the administration is in a much stronger position because it wins if nothing happens, whereas opponents must add and protect an amendment through the legislative process.

Why Tennessee? Opponents of the rule have questioned the expense of defending it when test cases of the *Quill* decision have already begun in other states. Com-

missioner Martin told the committee state officials believe Tennessee can make the strongest case for overturning *Quill* because it is so dependent on the sales and use tax, which generates 61% of state revenues. Also, a Tennessee law allows remote sellers to collect a flat 9.25% tax for the sake of simplicity, even though local rates vary. Local governments may impose a tax of up to 2.75% on top of the state's 7% levy.

Attorney General Slatery said he is "comfortable" the Department of Revenue has the authority to promulgate the rule and is prepared to defend it. He suggested that the evolution of technology has redefined what a "meaningful presence" is and questioned whether the Supreme Court now will limit nexus to physical office space "in a digital world."

Warring interests. Tennesseans for Main Street Fairness, an organization of retailers pushing for uniform collection, sent a letter to Senate Government Operations Chairman Mike Bell (R-Riceville) and Faison on Monday, calling for "fairness for Tennessee families, workers, businesses, and local communities."

NetChoice, an organization opposed to the rule, released results of a poll it commissioned that found 55% of Tennesseans would consider it a tax increase if they "had to start paying online sales tax for purchases from an out-of-state business." The survey did not point out that they already owe the tax.

A statewide poll by Vanderbilt University released last week included a question on the topic. When asked if "all online retailers that are based outside of Tennessee" should be required to "charge Tennessee residents the sales tax on their Internet purchases like in-state businesses do," 57% said no, while 38% said yes.

Rep. John Ragan (R-Oak Ridge), Stewart, and others argued that instead of through a rule from the Department of Revenue, a change in policy of this nature should be imposed through legislation. Administration officials cited a law the legislature passed in 1988 that among other things declares the intent of the General Assembly for remote vendors to collect the tax. The statute provides a basis for the rule, they said.

Shifting marketplace. The administration is concerned about the long-term trend toward online purchasing and its effect on the state's tax base. Martin cited a Reuters report that Black Friday sales at brick-and-mortar stores declined 10.4% from last year while online sales increased by 21.6%.

The National Retail Federation, pointing out that over Thanksgiving weekend in 2015 the numbers for in-store and online shopping were about even, estimates that this year 99.1 million Americans shopped at stores while 108.5 million shopped online.

In the legislative session that begins Jan. 10, the issue could become part of a maze of tax issues involving a \$1 billion revenue surplus, various tax cut proposals, and an expected administration plan to provide additional dedicated funding for transportation.

The administration will try to avoid a floor vote directly on the online-collections issue.

Tennessee News Digest

- Wacker Chemie AG said Thursday it will add a new \$150 million production facility at its operation in Bradley County, creating 50 new jobs. The \$2.5 billion the German company has already invested at the site since 2009 represents the largest single investment ever in Tennessee, according to ECD Commissioner Randy Boyd.
- House Speaker Beth Harwell said last Friday she plans to propose a rules

change in January to allow the House Ethics Committee to hear sexual harassment complaints.

- State revenue collections in November exceeded the budget estimate by \$6.8 million and totaled 0.48% more than in November 2015, officials said.
- Commerce and Insurance Commissioner Julie Mix McPeak is set to become president of the National Association of Insurance Commissioners in 2018. She

will serve as president-elect in 2017, having been chosen during the NAIC's fall meeting in Miami.

- Former GOP presidential candidate Jeb Bush, in Kingsport Monday to speak at a Mountain States Health Alliance leadership forum, praised President-elect Trump's appointment of Scott Pruitt to head EPA, saying the Oklahoma attorney general has the potential to "clean up an out-of-control" agency.

Political roundup

TennCare gets five-year waiver

Tennessee was granted a five-year Medicaid waiver today by the Centers for Medicare and Medicaid Services, TennCare director Dr. Wendy Long announced.

The state's previous three-year waiver expired June 30, and several temporary extensions were granted while state and federal officials worked on language to reduce dependence on provider funding pools without harming TennCare or hospitals. The waiver governs most of TennCare's \$11 billion-plus operation.

New coalition. A coalition called Tennessee Thrives, consisting of nearly 200 businesses, institutions, and organizations, has been formed to maintain "an open and inclusive Tennessee," the group said Tuesday.

It will oppose legislation it considers discriminatory — and likely to lead to boycotts like those North Carolina has experienced over a law on transgender bathroom usage. Tennessee lost at least a couple of conventions last year over enactment of a bill allowing counselors to refer a patient to someone else when the patient's goals and objectives conflict with the counselor's "sincerely held principles." Some groups interpreted the measure as "anti-LGBT."

Another bill on the subject already has been introduced for the 2017 session.

The new organization includes chambers of commerce and companies such as Nissan, LP, FedEx, and Bridgestone, along with Tennessee's Gannett newspapers. The Nashville Convention & Visitors Corp., which criticized the counseling bill, is involved.

Rep. Susan Lynn (R-Mt. Juliet), who in the 2016 session took off notice her bill requiring schoolchildren, with some exceptions, to use bathrooms and locker rooms consistent with the sex on the birth certificates, told *The Tennessean* this week she does not plan to reintroduce the bill, confident President-elect Trump will not "try to impose any political agenda on Tennessee where that is concerned." The 2016 bill was driven by a U.S. Department of Education push to the contrary.

Durham case. At least two witnesses appeared Wednesday before a federal grand jury investigating allegations of "bribery, mail fraud, and wire fraud" involving former state representative Jeremy Durham, *The Tennessean* reports today. The newspaper said it has obtained a copy of a subpoena that "reveals the

scope of the investigation." Durham, a Franklin Republican who lost in the August primary, was expelled from the House in September based on findings of sexual harassment. The Registry of Election Finance is looking into discrepancies in his campaign finance reports.

Pot for patients. Sen. Steve Dickerson (R-Nashville) and Rep. Jeremy Faison (R-Cosby) detailed Wednesday their plans for legislation to permit the use of marijuana for medical purposes. Dickerson and Rep. Ryan Williams (R-Cookeville), the new House Republican Caucus chairman, sponsored a bill on the issue in the last general assembly that died in committee.

The bill provides for 50 pot-growing operations across the state, with 15 designated for distressed areas. Medical marijuana would be allowed for a list of conditions that includes cancer, HIV/AIDS, Alzheimer's, and Lou Gehrig's disease.

Berke challengers. Five candidates met Thursday's qualifying deadline in the March 7 Chattanooga mayoral election. Mayor Andy Berke, seeking a second term, is opposed by Councilman Larry Grohn, former council member David Crockett, Chris Long, and Gail M. Francis. The withdrawal deadline is next Thursday.

Disaster. President Obama issued a disaster declaration Thursday for Sevier County, where wildfires this month killed 14 people and caused an estimated \$500 million in damage.

Charter halt halted. Metro Nashville school board member Will Pinkston deferred indefinitely Tuesday his resolution for a moratorium on new charter schools after the Nashville Area Chamber of Commerce and other groups aggressively opposed it.

Miss Lolly. Loiette Hume Henry, wife of former senator Douglas Henry of Nashville for 67 years, died Monday at home. She was 89.

Memphis IKEA. City officials took part in a log-sawing ceremony Wednesday morning to dedicate the new IKEA store that opened near Germantown Boulevard and I-40 in Memphis. Thousands of people, including several who had camped out in the parking lot for days, were in line when the doors opened.

Official strategist. Nashville Mayor Megan Barry announced Tuesday the appointment of Brian Kelsey as "chief strategy officer" for Metro government, a new position. Not to be confused with the state senator, he is an economic researcher and planner from Austin.

Tennessee Notes & Quotes

■ **Allan Ramsaur**, executive director of the Tennessee Bar Association for nearly 20 years, will begin stepping back from day-to-day administrative responsibilities in January and assume the title emeritus director. Ramsaur, who will continue to lobby for TBA and work on court administration and other issues, will assist in the search for a new executive director and in the transition. During his tenure, TBA's membership has more than tripled to 13,000. Ramsaur earlier served as the first director of the Nashville Bar Association.

■ Memphis Mayor **Jim Strickland** is researching local water-permit procedures with an eye toward giving the city power of approval over future permits. Strickland, an opponent of TVA's plan to use water from the Memphis sand aquifer to cool a new power plant, was not allowed to speak at the Shelby County Water Quality Control Board's meeting two weeks ago in which the Sierra Club's appeal of well-drilling permits for TVA was unanimously rejected. A freshly incorporated Protect the Aquifer organization, including the Sierra Club and assorted other groups, plans to challenge the board's decision in chancery court. Meanwhile, Senate Minority Leader **Lee Harris** (D-Memphis) and Sen. **Brian Kelsey** (R-Germantown) are planning bipartisan legislation to address the issue. The aquifer is the source of the city's drinking water.

■ "Mr. Tillerson is a very impressive individual and has an extraordinary working knowledge of the world." — *U.S. Sen. Bob Corker (R-Chattanooga), on President-elect Donald Trump's choice of ExxonMobil CEO Rex Tillerson as secretary of state. Corker himself was among those considered for the position.*

■ As chairman of the 19-member Senate Foreign Relations Committee, **Corker** will run the confirmation hearing on **Tillerson**, whose ties with Russian leader **Vladimir Putin** have drawn bipartisan scrutiny.

■ "**Jimmy Haslam** deposed." — *Headline Wednesday on a story in NashvillePost.*

■ No, the Knoxville businessman and brother of Gov. **Bill Haslam** hasn't been overthrown in a hostile takeover. He's still president of Pilot Flying J and owner of the Cleveland Browns. He gave an eight-hour deposition Tuesday in a lawsuit filed by three trucking companies that did not agree to Pilot's \$85 million settlement of a class action lawsuit over its diesel fuel rebate practices. The company settled with 5,500 trucking firms in 2013. Pilot, whose Knoxville offices were raided by the FBI in April 2013, also has settled with the Justice Department.

■ "FedEx is at the nexus of global trade. We move 12 million shipments daily, serving 220 countries and territories . . . and we consider all FedEx jobs to be trade jobs." — *FedEx chairman Fred Smith, in a speech at the National Competitiveness Forum in Washington in which he warned that President-elect Trump's threat to withdraw from NAFTA would be "catastrophic for the U.S. economy." FedEx is Tennessee's second-largest non-government employer behind Walmart.*

■ Rep. **Gary Hicks** (R-Rogersville), whose annual salary as technology director for Rogersville City School is \$67,519, recently requested leave for the duration of the next legislative session, according to the *Kingsport Times News*. But city school director **Rebecca Isaacs** told the school board Tuesday she is implementing a plan to pay Hicks \$32.47 a hour when he works remotely while in Nashville.

■ Lawyer/lobbyist **Nathan Ridley** has been elected president of the Nashville Bar Association.

■ Lobbyist **Jim Schmidt** has added an associate, **Melanie Bull**, most recently public policy director for the Tennessee Disability Coalition.

■ The state Senate Democratic Caucus, which consists of five members, reelected its leadership Tuesday: Minority Leader **Lee Harris** (D-Memphis) and Caucus Chairman **Jeff Yarbrow** (D-Nashville). The leaders have indicated that although Democrats are outnumbered, they intend to be vocal on some important issues, including the potential outsourcing of facilities management at higher education institutions.

■ "We plan to be more international about getting the word out on issues." — *Senate Minority Leader Lee Harris (D-Memphis), in a news release, on Democrats' role in the Senate in the upcoming session.*

■ We suspect what **Harris** actually said was that Senate Democrats plan to be more "intentional." Autofill and spell-check can be dangerous. At our company, spell-check once "fixed" an apology to an elderly subscriber who had missed an issue of a legal newsletter: "We're sorry about your incontinence."

■ U.S. Rep. **Scott DesJarlais** (R-South Pittsburg) spoke less on the House floor in the 114th Congress than any member who served the entire two years, according to *USA Today*. He spoke only once, April 14, when for a full minute he extolled the wonders of the National Cornbread Festival in his hometown. But that's okay. We prefer quiet congressmen to those who blab nonsensically.

■ Residents of a 2,000-acre section of Williamson County targeted for annexation by Thompson's Station agreed in an election Thursday to join the town. Turnout was 100%, though no one voted on election day. Although all ballots were cast during the two weeks of early voting, election officials had to be on hand for the duration, under the law. The proposition passed 2-0, according to the county election commission.

■ How the election came about is a long story. Suffice it to say a major development is planned for the farmland in dispute and neighbors are vehemently opposed. The owners, **Portia** and **Gary Baker**, favored the annexation, and after some government maneuvering and a court ruling, the election was arranged as prescribed in state law, with the Bakers the only eligible voters.

■ There have been no charges of Russian meddling.

■ Because of the holidays, *The Tennessee Journal* will publish a day early next week.