Tax Sharing: California and Texas Take Different Intrastate Sales Tax Approaches Post *Wayfair*

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In 2018, the United States Supreme Court ruled in *South Dakota v. Wayfair* that states may charge sales tax on purchases made from out-of-state sellers, even if the seller does not have a physical presence in the state. The decision spurred legislation to address interstate sales tax for online goods, but it has also generated scrutiny of the treatment of intrastate sales in some states, including California and Texas.

Traditional brick and mortar sales generally were *origin* based – taxable at the location of the sale. However, sales from online retailers are now generally taxed based on the *destination* of the goods. For instance, if you live in California and buy goods from an out of state retailer, without a physical presence in California, the retailer will have to collect and remit California tax (use tax). The local portion of the tax would be allocated to the destination where the goods were shipped (for instance, your house).

What happens if the retailer has a distribution center in state, and your purchase is shipped from that distribution center?

The treatment of intrastate sales can create a substantial benefit for the locality where the distribution center is located. This has also presented an economic incentives opportunity for businesses in states that allow local tax sharing agreements, providing businesses an opportunity to capture a portion of local sales tax as an incentive to locate their distribution centers in that locality.

California and Texas both allow local jurisdictions to enter into a tax sharing agreement (TSA) with a business, permitting the local jurisdiction to share its portion of sales/use taxes with the retailer as an incentive to locate its distribution center in the locality. Opponents of TSAs argue that the agreements are ineffective and pit one community against another in a race to reduce the overall revenue available. Supporters argue that TSAs are a means for smaller communities with fewer resources to attract jobs.

Against this backdrop, we are seeing these two different perspectives play out in two of our largest states.

California

On October 12, 2019, California Governor Gavin Newsom vetoed Senate Bill 531, which would have prohibited local jurisdictions from entering into TSAs that would directly or indirectly rebate sales/use taxes to retailers that locate or maintain a place of sale within that local jurisdiction. Instead, Governor Newsom signed Assembly Bill 485, which requires greater reporting and transparency with respect to such TSAs. Governor Newsom was ultimately persuaded that the current use of these TSAs are an important local economic development tool, particularly to support rural and inland communities facing high unemployment rates.

Texas

On January 3, 2020, the Texas Comptroller of Public Accounts (Comptroller) published proposed revisions to §3.334 of Texas Administrative Code, Title 34, Part 1, Chapter 3, Subchapter O. The Comptroller determined that, in light of *Wayfair* and Texas House Bills 1525 and 2153, both passed in 2019, that remote sellers that are required to collect Texas sales/use tax should collect the tax based on the *destination*, not the *origin*. The Comptroller also found that companies were using the complex sales tax rules to take the position that their internet sales are originated at the customer service center processing the order. The Comptroller explicitly addressed purchasing offices established solely to rebate or avoid a portion of the local sales tax, and further clarified that orders placed on a website "are not received at a place of business of the seller in Texas" (Subsection (c)(6)(A) of §3.334). Subsection (c)(6)(D) further provides that when a seller fulfills an internet order at a location in Texas that is not a place of business of the seller in Texas, then the sale is consummated at the location in Texas to which the order is shipped or delivered, or where the purchaser takes possession. Thus, in general, online intrastate sales should be treated like online interstate sales, with the local tax allocated to the destination of the goods (the purchaser's home).

The proposed rule has sparked strong views from both sides of the issue, with cities like Round Rock (City), which is home to Dell Technologies (Dell), asserting that the vast majority of Dell's $29,000,000 per year in the local portion of the sales tax from intrastate sales will now be spread to localities throughout the state (based on the destination of the goods), resulting in a loss of $20,000,000 annually for the City and $9,000,000 annually for Dell. With 35 years left on the agreement, this is a billion dollar issue for the City and Dell.

In a February 4, 2020 editorial, Glenn Hegar, the Comptroller, noted that the change is intended, following a grace period for existing TSAs through December 31, 2022, to effectively prevent some Texas cities and retailers from using a "tax loophole to capture tax revenue that ought to go elsewhere." Comptroller Hegar noted that taxpayers do not pay local sales tax on internet purchases expecting the taxes to be distributed to the businesses and cities nowhere near their communities.

Following a public hearing on February 4th, the Comptroller extended public comments to April 3, 2020. The final rule has not yet been released. If and when it is released, Texas' approach may stand in stark contrast to Governor Newsom's approach in California, set forth in his Senate Bill 531 Veto Message, which is focused on California continuing to provide TSAs, a "limited but also an important local tool . . . particularly in rural and inland California cities that continue to face significant economic challenges . . ."

while supporting additional transparency for TSAs.