North American Accounting Studies
Vol. 5, No. 1
2022
PP 18-35

History of the Use Tax in the United States

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Abstract

The use tax was developed by states to complement the sales tax. The aim was to prevent residents from being able to avoid paying the sales tax by simply going to a different state to make a purchase. Unlike the sales tax, which is collected by businesses at the point of sale, the use tax is self-reported by individuals. Since its inception in the United States in the 1930s, compliance with the use tax has been close to zero. This article examines the history of the use tax in the United States, including its original intent, enforcement issues, court cases, state efforts to increase compliance, and federal legislation that never happened.

Keywords: Use tax, history, tax compliance

Introduction

Outside of the income tax, the most salient tax in the United States is the sales tax. Currently, 45 of the 50 states have some form of sales tax, with rates varying from 7.25% (in California) to 2.9% (in Colorado).[1] Technically, it is the purchaser of a good who owes the sales tax; however, it is the seller who is responsible for collecting the tax and remitting it to the taxing authority. While there are complexities (e.g., sales tax holidays, what items are tax exempt, etc.), the basic premise of the sales tax is relatively easy to understand – a person buys an item and owes a tax on the purchase; the business collects the tax and remits it to the state.

While the collection of the sales tax is simple, an issue that plagued the collection of the sales tax was purchasing from businesses out of state. From the inception of the sales tax, customers purchasing items via catalog (e.g., Sears, Roebuck & Co. Catalog) rarely paid sales tax on the items. The problem grew via internet purchases in more recent times. Another common situation was a person from one state making a purchase in a second state with a differing rate. While purchasers may have assumed that there was no tax owed because the seller did not collect the sales tax, this assumption was incorrect. The individual owed something called a use tax.

The use tax has been around in the U.S. since the 1930s. A technical definition of the use tax is a tax on, "using, storing or otherwise consuming tangible personal property within a given state" (Carlson, 1941: page 223). A more layman's definition of use tax is the sales tax a resident of one state should have paid on a purchase but did not. Use taxes are intended to complement sales taxes, and states allow a taxpayer to offset any use tax owed by sales tax previously paid on the purchase. Because the burden of paying the use tax falls on the individual, enforcement is difficult. Following the Supreme Court's decision in *South Dakota v. Wayfair Inc., et al.* (585 U.S.___ 2018), this burden has increased (Kim, 2020). While the sales tax may be more salient,

[1] While this paper focuses on the general sales and use tax, the same rules also apply to excise taxes. An excise tax is a sales tax on a specific item (e.g., tobacco, alcohol, or gasoline).

the use tax acts as an important complement and the costs of compliance often are intertwined (Cardillo, Holt, and Schlaufman, 2021).

This article examines the history of the use tax. It focuses primarily on enforcement issues states have faced including major court cases, attempted legislation, and other remedies that have been tried over the years. This topic should be of interest to CPAs and business owners. CPAs should be aware of changes to sales and use taxes to better serve their clients and to be aware of attempts to tax accounting services. According to the AICPA, three states impose a sales and use tax on accounting services. Due to a decrease in state revenues, the AICPA reports that proposals to impose a sales and use tax on accounting services have been introduced in state legislatures across the country (Spencer, 2021). If implemented, the costs of compliance and payment of the taxes represent a significant burden on accounting firms. Accounting firms can perform services in one state for a client located in another state. This creates an administrative burden for firms and states.

According to the U.S. Government Accountability Office (GAO) (2017), the costs of complying with the sales and use tax include software, compliance, and liability. The GAO found that software licensing costs from $12 per month to $200,000 per year. The GAO estimated that businesses spend up to $2,000,000,000 on compliance costs per year. In addition to compliance costs, business owners also incur the burden of reduced sales from the enforcement of sales and use taxes. In a study on the impact of sales and use taxes on the sales of Amazon, Baugh, Ben-David, and Park (2018) find that consumers spent 9.4% less on goods because of taxes following the *Wayfair* decision.

The topic of this article should be of interest to accounting and business students. Sales and use taxes impact businesses and individuals in almost every state. As consumers, students should understand the taxes they owe. As professionals, it is likely that an accounting or business student will have to work on some component of the sales and use tax, whether as a practitioner or a business owner. Unfortunately, due to resource constraints, very few students are exposed to sales and use taxes in class even though it is a large component of business expense. Specific to accounting students, if they are employed at an accounting firm, they will work with clients who have sales and use tax issues and need an understanding of the laws.

Origins of the Use Tax

By 2015, every taxing authority that has a sales tax also has a use tax of the same rate. The sales tax, however, came into existence first. The collection of sales taxes on transactions has been documented as early as 2000 BC. Early Roman civilization is credited with spreading the tax to the rest of Europe (Fox, 2002). In the U.S., Mississippi is credited as being the first state to adopt the general sales tax in 1932 (Emanuel and Borean, 2014).[2]

The use tax was developed to be a complement to the sales tax. Carlson (1941) states the support for the use tax came from two groups. The first group is those concerned with the protection of revenue (i.e., the taxing municipalities). The second group is those concerned with protecting the state's businesses. In essence, this argument suggests that a business is at an inherent disadvantage if they must charge a sales tax of 5% on their products, but a consumer can go across the state's border to an identical business that has to charge only 1%. Coincidently, in 2022, proponents of the use tax still use the same arguments to support why the United States needs to change its laws to make the use tax easier to collect.

[2] It should be noted, however, that various taxes that are similar to the sales tax appeared before this. For example, Pennsylvania had a mercantile tax in 1821; Kentucky levied a tax on retailers in 1930, and then eliminated it in 1936 (Fox, 2002).

Based on a review of state statutes, the first recognized use tax was enacted in Louisiana in 1934.[3] There is a common misconception that all states created sales tax and use tax at the same time. Several states did, but other states had the sales tax first, and later created the use tax. For example, the first state to adopt a general sales tax, Mississippi, did not implement the use tax until 1942. Table 1 shows the year each state adopted the sales tax, the use tax, and the original use tax rate.

Table 1
Year State Adopted Sales and Use Tax and Original Use Tax Rate

State	Sales Tax	Use Tax	Original Use Tax Rate
Alabama	1936	1939	2.0%
Alaska	N/A	N/A	N/A
Arizona	1933	1955	2.0%
Arkansas	1935	1949	2.0%
California	1933	1935	3.0%
Colorado	1935	1935	2.0%
Connecticut	1947	1947	3.0%
Delaware	N/A	N/A	N/A
Florida	1949	1949	3.0%
Georgia	1951	1951	3.0%
Hawaii	1935	2000	4.0%
Idaho	1965	1965	3.0%
Illinois	1933	1955	2.5%
Indiana	1962	1962	2.0%
Iowa	1933	1937	2.0%
Kansas	1937	1937	2.0%
Kentucky	1960	1960	3.0%
Louisiana	1938	1934	Undetermined
Maine	1951	1951	2.0%
Maryland	1947	1947	2.0%
Massachusetts	1966	1966	5.0%
Michigan	1933	1937	3.0%
Minnesota	1967	1967	3.0%
Mississippi	1932	1942	2.0%
Missouri	1934	1959	2.0%
Montana	N/A	N/A	N/A
Nebraska	1967	1967	2.5%
Nevada	1955	1955	2.0%
New Hampshire	N/A	N/A	N/A
New Jersey	1966	1966	3.0%

[3] The Louisiana date is strange because, according to official documents from the state, the general sales tax itself was not implemented until 1938. E-mails to state officials did not clear-up the confusion. Likely, Louisiana had an excise tax on product(s) in 1934 and attached a use tax to those. The excise taxes were eliminated after the general sales tax was enacted, but the use taxes remained. As tax laws are wont to do, Louisiana would repeal the sales and use taxes in 1940, only to bring both back in 1948 (Darkin 1940) (Sales Tax Institute 2021).

New Mexico (compensating tax)	1933	1935	2.0%
New York	1965	1965	2.0%
North Carolina	1933	1939	3.0%
North Dakota	1935	1939	2.0%
Ohio	1934	1936	3.0%
Oklahoma	1933	1937	2.0%
Oregon	N/A	N/A	N/A
Pennsylvania	1953	1953	1.0%
Rhode Island	1947	1947	1.0%
South Carolina	1951	1951	3.0%
South Dakota	1933	1939	2.0%
Tennessee	1947	1947	2.0%
Texas	1961	1961	2.0%
Utah	1933	1937	2.0%
Vermont	1969	1969	3.0%
Virginia	1966	1966	2.0%
Washington	1933	1935	2.0%
West Virginia	1933	1951	2.0%
Wisconsin	1961	1961	3.0%
Wyoming	1935	1937	2.0%

Early Problems of the Use Tax

States quickly discovered collecting the use tax was difficult. Unlike the sales tax, which the business collects at the point of sale, the taxpayer is responsible for remitting the use tax to the state. This difference arose due to the Due Process Clause of the 14th Amendment, which states, "nor shall any state deprive any person of life, liberty, or property, without due process of law" (U.S. Const. amend. 14, §1). This clause prevents one state from imposing a tax on citizens/businesses of a second state that have no connection to the first state. Further, Article 1, Section 8, Clause 3 of the U.S. Constitution, more commonly known as the *Commerce Clause*, states, "Congress shall have the power to regulate commerce with foreign nations, and among the several states, and with Indian tribes." More pertinent to the use tax is the *dormant Commerce Clause*. The dormant modifier refers to the implied rule in the Commerce Clause that states cannot pass laws that excessively burden interstate commerce (Cornell University Law School n.d.).

By its very nature, the use tax is imposed when a citizen does not pay the sales tax on an item and then uses, consumes, or stores said item in their state. For obvious reasons, most individuals simply did not (and still do not) comply. Thus, states attempted to have out-of-state businesses help with collection. The out-of-state businesses fought collection by citing the Due Process Clause and dormant Commerce Clause.

What has emerged from this setting is a constant battle between states trying to collect the use tax, and neither the citizen of the state nor the business from where the product was purchased wanting to pay the use tax.[4] For a good period, this battle took place in the courts. Later, states used other means to enforce payment – new state laws, potential federal laws, and

[4] Although not identical, a similar problem exists with the various VAT rates in European countries. For example, a citizen of Denmark might travel to Germany to make a purchase due to the lower VAT in Germany.

even coalitions with other states – with varying degrees of success. This article explores the successes and, until recently, many failures of these collection efforts.

Supreme Court Cases (pre-Wayfair)

Although there have been many court cases throughout the years at various jurisdiction levels, this paper focuses on cases that have made it to the Supreme Court. The discussion below presents the cases chronologically organized around key outcomes. The first section discusses two cases that form the foundation for the constitutionality of the collection of consumption-based taxes. The next case establishes the constitutionality of the use tax specifically. The final eleven cases determine when a business activity establishes nexus within a state, a key component for the collection of the use tax. Nexus is the connection between a state and the vendor. For a state to enforce collection from a business, there must be nexus between that state and the said business.

A key component in the cases is the state attempting to compel an out-of-state business to function as an agent of the state by collecting and remitting use taxes for purchasers within the state. Mechanically, this meant that the use tax operated identically to a sales tax.

Foundation for Constitutionality of the Use Tax

Two cases that involved the imposition of a gasoline tax on out-of-state companies are *Bowman v. Continental Oil Co*., 256 U.S. 642 (1921) and *Monamotor Oil Co. v. Johnson*, 292 U.S. 86 (1934). In both cases, the states imposed a gasoline excise tax on the use of gasoline in the state, and, in both cases, the states required the companies to function as agents for the state in collecting and remitting the tax for in-state consumers. These two cases would provide the Supreme Court with the foundation for upholding the constitutionality of a consumption-based tax by an out-of-state vendor.

In *Bowman*, the case centered on the imposition of a gasoline excise tax for the use of gasoline in New Mexico. Continental Oil Company shipped gasoline into New Mexico to be sold and delivered to customers. While a small percentage of sales were of original barrels brought in from out of state, most sales were of gasoline that was not in its original form when transported across state lines. Continental Oil Company argued that it was not subject to New Mexico taxes due to the interstate commerce clause. The court found that the gasoline tax did not violate the interstate commerce clause. Although the actual outcome of the case is not relevant to the use tax, an order given in the decision mattered greatly. Specifically, the court required the company to, "render detailed statements of all gasoline received, sold, or used by it, whether, in interstate commerce or not, to the end that the state may the more readily enforce said excise tax to the extent that it has the lawful power to enforce it as above stated" (256 U.S. at 650). The courts later would use this as precedence in requiring companies to provide information to states to determine the sales/use tax due.

In *Monamotor*, Iowa imposed a two cents per gallon tax on all motor vehicle fuel used or disposed of in the state for any person using motor vehicle fuel in the state. The state required distributors to collect the use tax from consumers and remit payments to the state. Monamotor Oil Company, an out-of-state company that imported gasoline into Iowa for resale, argued that the tax was a burden on interstate commerce. The court upheld the constitutionality of the excise tax and the right of the state to have the distributor function as an agent for the state in the collection of the gasoline tax. The court reasoned that the excise tax was for the use of fuel after it was in Iowa and not a direct tax on fuel imported into the state; therefore, the tax was not a burden on interstate commerce.

The *Bowman* and *Monamotor* cases provided the legal justification for a use tax. While the gasoline taxes in the two cases were called excise taxes, they were a tax on the use of a good. Further, the courts allowed states to compel out-of-state companies to function as an agent for the collection of these taxes. In both cases, the collection of the gasoline tax was similar to the collection of an in-state sales tax.

Direct Challenge to the Constitutionality of the Use Tax

Henneford v. Silas Mason Co., Inc., 300 U.S. 577 (1937) was a direct challenge to the constitutionality of the use tax on the theory that the use tax violated the Commerce Clause. Silas Mason Company was a firm hired as contractors and subcontractors in the construction of the Grand Coulee Dam on the Columbia River in Washington State. The company had brought in various pieces of equipment and materials bought in other states that had a cost of $921,189.34. In 1935, the state of Washington passed a 2% sales tax and a complementary 2% use tax. The use tax applied to the use of any tangible personal property in the state, and could be offset by a previous payment of sales or use to the state or another state.[5] The state of Washington sought to collect its 2% use tax of $18,423.78 on these items. The company argued that the use tax was a violation of The Commerce Clause.

Citing *Monamotor*, the Supreme Court ruled in the state's favor, using the rationale that the tax was applied to property after delivery was completed and not on the delivery itself. The court opined, "the tax is not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end" (300 U.S. at 582). It is important to note that the court did mention that the fact that Washington allowed the use tax due to be offset by sales tax paid in other states was important in the decision. The case would be used as precedent for the constitutionality of the use tax.

Establishing Nexus

With the constitutionality of the use tax decided in *Henneford*, cases involving the use tax concerned primarily with the circumstances where an out-of-state company's activities created nexus within a state. In *Felt & Tarrant Mfg. Co. v. Gallagher,* 306 U.S. 62 (1939), Felt & Tarrant was an Illinois corporation that sold comptometers (i.e., a mechanical calculator). The company had two agents in California that solicited orders. Felt & Tarrant paid commission, rent for an office, and a salary for a demonstrator, and reimbursed travel expenses to the agents. California statutes required retailers to collect use tax from purchasers of tangible personal property, and the state demanded the agents of Felt & Tarrant to collect use tax on orders placed through the agents. Felt & Tarrant argued that the agents, not the company, maintained an office in California, and machines were shipped from out of state; therefore, the company should not be compelled to collect the use tax because it was not a retailer subject to the California statutes.

Relying upon *Henneford, Bowman,* and *Monamotor*, the court ruled in the state's favor. The court determined that the tax was not a tax on interstate commerce, but upon the use of property after commerce is ended (*Henneford*). The court recognized the right of the state to require a seller to provide detailed statements on sales of goods so that the state may enforce the tax (*Bowman*), and the state may require the seller to function as its agent to collect a tax (*Monamotor*). Although later cases with similar facts would become more widely known, this case was one of the first to find that having an agent of a company in a state was enough to establish a presence in the state, and the company would have to collect the use tax.

[5] Table 1 identifies 1933 as the first year Washington adopted a sales tax. We use that year since the state of Washington first imposed a general excise tax in 1933 and codified a general sales/use tax 1935 (Department of Revenue Washington State 2022).

Two cases involving the collection of the use tax on catalog sales by out-of-state companies were *Nelson v. Sears, Roebuck & Co*., 312 U.S. 359 (1941) and *Nelson v. Montgomery Ward & Co., Inc.,* 312 U.S. 373 (1941). Both cases had similar fact patterns, and were argued (January 13th, 1941) and decided (February 17th, 1941) on the same days of the year, but were not consolidated. Sears, Roebuck, & Co., and Montgomery Ward & Co. each had branches located in Iowa. The two companies collected sales tax on all sales made in these locations. Each company also allowed Iowa residents to place orders via catalog that were processed, fulfilled, and shipped from outlets in various states other than Iowa. Similar to *Felt & Tarrant Mfg.*, the state was seeking for the companies to function as an agent for the state by collecting use tax on these orders. Relying upon its prior rulings (*Henneford, Monamotor, and Felt & Tarrant Mfg.*), the Supreme Court ruled in the favor of Iowa in both cases.

The key finding would be used as a precedent for the later cases – if you have a physical presence in the state, you must collect the use tax in the event a resident of the state purchases the item via catalog/mail order regardless of the state in which the order is fulfilled. The court in *Nelson v. Sears, Roebuck & Co*. stated, “Iowa can exact this burden as a price of enjoying the full benefits flowing from its Iowa business” (312 U. S. at 364). Further, there was no violation in interstate commerce because the sales and use tax are complementary, and these companies already are required to pay sales tax on sales in the state.

Two cases that determined whether a sales agent created nexus within a state were *McLeod v. J.E. Dilworth Co.,* 322 U.S. 327 (1944) and *General Trading Co. v. State Tax Commission,* 322 U.S. 335 (1944); however, one case involved the assessment of a sales tax (*McLeod*) and the other the collection of a use tax (*General Trading Co.*). Similar to the two *Nelson* cases, these two cases were argued separately (February 4th, 1944) and decided (May 15th, 1944) on the same days of the year, but not consolidated. Both cases had similar fact patterns involving traveling salespeople doing business in a state outside of their headquartered state. Further, neither company had any association with the state other than the traveling salespeople. J.E. Dilworth was a Tennessee company whose salesperson traveled into Arkansas to solicit orders. General Trading Co. was based in Minnesota and sent salespeople into Iowa to solicit orders. What separated the two cases was the type of tax each state was looking to impose. Arkansas was looking to collect the sales tax from J.E. Dilworth, and Iowa wanted General Trading Co. to function as its agent in the collection of the use tax, similar to *Monamotor* and the two *Nelson* cases.

In *McLeod*, the Supreme Court ruled for J.E. Dilworth and against the collection of the sales tax. The court determined that the sales took place in Tennessee; therefore, a sales tax on goods sold in another state was unconstitutional. In *General Trading Co.*, the Supreme Court ruled for the Iowa State Tax Commission while citing *Felt & Tarrant Mfg.* and the two *Nelson* cases.

The two decisions created an interesting situation – having a traveling salesperson in a state was enough to subject a company to a state’s use tax laws, but not for the state to collect the sales tax. The distinction, as of 2015, is largely moot regarding collecting tax revenue because all states that have a sales tax also have a use tax. That was not the case, however, for many states for several years (see Table 1). Arkansas, for example, despite claiming in the J.E. Dilworth Co. case that they could enforce the use tax if they had one, still did not impose one until 1949 (four years after this case was decided).

In addition, these two cases also created a clear divide between sales and use taxes. In *Dilworth*, the court stated, “A sale tax and a use tax in many instances may bring about the same

result. But they are different in conception, are assessments upon different transactions, and, in the interlacing of the two legislative authorities within our federation, may have to justify themselves on different constitutional grounds" (322 U.S. at 330). Further, the court stated, "A sales tax is a tax on freedom of purchase… A use tax is a tax on the enjoyment of that which is purchased…a tax on an interstate sale like the one before us and unlike the tax on the enjoyment of the goods sold, involves an assumption of power by a State which the Commerce Clause was meant to end" (322 U.S. at 330).

In *Miller Brothers v. Maryland,* 347 U.S. 350 (1954), Miller Brothers was a merchandising company located and operating in Delaware. It did not directly contact potential buyers in Maryland, did not advertise in Maryland, and did not take orders by mail or telephone. Residents of Maryland, however, came to Delaware to make purchases. Miller Brothers would ship purchased goods to the residents of Maryland via common carrier or Miller Brothers' trucks. Maryland attempted to require Miller Brothers to collect use tax for Maryland residents that purchased goods from Miller Brothers, even going as far as seizing one of their delivery trucks. The Supreme Court ruled that simply having a delivery truck in the state was not equivalent to maintaining a branch and did not create enough contact with the state to force the company to collect use tax. The court distinguished *Miller Brothers* from *General Trading Co.* by stating that an occasional delivery of goods, as was the case in *Miller Brothers*, was not the equivalent of having a salesperson regularly enter the state to solicit orders and deliver goods, the facts in *General Trading Co*.

In *Scripto, Inc. v. Carson,* 362 U.S. 207 (1960), Scripto, Inc. was a Georgia-based company that made writing instruments. They had no office in the state of Florida, but they did have 10 wholesale brokers that solicited orders in Florida. This was enough for Florida to demand Scripto, Inc. collect use tax for customers from Florida. Applying the precedents established in *General Trading Co.* and *Miller* Bothers, the Supreme Court ruled in the state's favor. Interestingly, approximately 50 years later, New York would start demanding use tax collection from major corporations using the same logic.

A case that determined whether a company with no physical presence in a state could be required to collect use tax was *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois,* 386 U.S. 753 (1967). National Bellas Hess, Inc. was a mail-order company operating out of Missouri. They had little direct connection to Illinois other than sending catalogs and flyers to the Illinois residents. Orders were shipped via mail or a common carrier. This was enough for Illinois to demand National Bellas Hess, Inc. collect and remit the use tax to the state. The Supreme Court, citing *Miller Brothers* and the Commerce Clause, said a state could not enforce use tax collection on a vendor that had no physical presence in the state.

In the opinion, the Court wrote, "for if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The variations in rates of tax, in allowable exemptions, and administrative and recordkeeping requirements could entangle National's interstate" (386 U.S. at 759). At the time, the justices cited over 2,300 taxing jurisdictions using a total of eight different tax rates varying from 2 to 5 percent. This decision would be cited as precedent for the determination that a company must have a physical presence in a state to create nexus.

In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), the issue did not involve the use tax; rather, the issue was a privilege tax. Complete Auto Transit, Inc. was a Michigan-based company that helped deliver General Motors vehicles in Mississippi. Complete Auto

Transit, Inc. would unload General Motors vehicles from trains in Mississippi and deliver them to dealerships. The company was paid on a contract basis for transportation from the railyard to the dealers' lots. Mississippi determined this created nexus to collect a privilege tax. The privilege tax was a 5% tax on the gross income of the business for the privilege to engage business within the state. Complete Auto Transit, Inc. argued that the collection of the tax would impede interstate commerce. On appeal to the Mississippi Supreme Court, the court affirmed the tax, concluding that Complete Auto Transit, Inc. had a large operation within the state and relied upon state resources the same as other citizens. The Supreme Court affirmed the ruling of the Mississippi Supreme Court.

The Court laid out four specific rules as to when a state tax was constitutional under the Commerce Clause. It stated that a tax did not violate the Commerce Clause when it is, "applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State" (430 U.S. at 279). The court did not define what created substantial nexus or whether physical presence was necessary to create nexus.

National Geographic Society v. California Board of Equalization, 430 U.S. 551 (1977) determined whether a segment of a corporation could create nexus for the entire corporation. Although most know of the monthly *National Geographic Magazine*, the parent company, National Geographic Society, was a non-profit company headquartered in the District of Columbia. National Geographic Society maintained two offices in California that solicited advertising for its monthly magazine. In addition to the magazine, National Geographic Society had a mail-order business that sold assorted items, such as maps and globes, from their District of Columbia headquarters. The offices in California performed no activities related to the mail-order business. Orders for the assorted items were mailed directly to the headquarters by purchasers on a form included in the magazine, and deliveries were mailed from the District of Columbia or Maryland. California demanded that the National Geographic Society collect use tax for the mail-order purchase of the assorted items.

The Supreme Court ruled that there was enough connection between the Society and California that they had to collect and remit use tax. Citing *Felt & Tarrant Mfg.*, *General Trading Co.*, the two *Nelson* cases, and *Scripto, Inc.*, the court determined that National Geographic Society's two offices in California created nexus in the state. The ruling set the precedent that nexus could be determined at the corporation level, and not the individual segments or divisions in the corporation. As the court stated, "the relevant constitutional test to establish the requisite nexus…is not whether the duty to collect the use tax relates to the seller's activities carried on within the state, but simply whether the facts demonstrate 'some definite link, some minimum connection, between the state and the person" (430 U.S. at 560).

Until the *Wayfair* decision, *Quill Corp. v. North Dakota* (504 U.S. 298 1992) would be the controlling ruling on whether physical presence was necessary to create nexus. Quill Corp. was a Delaware-based corporation that sold office equipment and supplies. Although they did have offices and warehouses in various states (Illinois, Georgia, and California), they had no direct connection to North Dakota. Nonetheless, North Dakota determined that Quill Corp. should collect and remit use tax on purchases by North Dakota residents. The state argued that Quill Corp. continually engaged in business in North Dakota through flyers and catalogs, and this activity created nexus with the state. North Dakota asked the Supreme Court to reexamine *National Bellas Hess, Inc*., using the theory that *Complete Auto Transit, Inc.* had determined that physical presence was no longer necessary to create nexus. The state also argued that the

economic impact of catalog sales had become large, and the economy had evolved to a point that reexamination was necessary.[6] The court ruled for Quill Corp, combining the findings of *National Bellas Hess, Inc.* and *Complete Auto Transit, Inc*., that a company must have a physical presence in the state for nexus to be created and the state to collect a use tax. Further, the Court pointed out that Congress could finally end this debate by passing legislation.

Table 2 provides a summary of all the cases discussed above.

Table 2
Summary of Supreme Court Cases

Court Case	Year	Key Outcome
Bowman v. Continental Oil Co., 256 U.S. 642	1921	Companies must provide states with information to help determine sales/use tax due.
Monamotor Oil Co. v. Johnson, 292 U.S. 86	1934	An excise (sales) tax on the use of a commodity is constitutional.
Henneford v. Silas Mason Co., Inc., 300 U.S. 577	1937	A use tax is constitutional.
Felt & Tarrant Mfg. Co. v. Gallagher, 306 U.S. 62	1939	Having an agent in the state established nexus. This, in turn, would require a company to collect sales/use tax.
Nelson v. Sears, Roebuck & Co. 312 U.S. 359 & Nelson v. Montgomery Ward & Co., Inc. 312 U.S. 373	1941	If a company had nexus in a state, they had to collect sales/use tax from customers in said state on catalog sales.
McLeod v. J.E. Dilworth Co., 322 U.S. 327 & General Trading Co. v. State Tax Commission, 322 U.S. 335	1944	A traveling salesperson did create nexus for the use tax. In addition, the cases did create a distinction between the sales and use tax.
Miller Brothers v. Maryland, 347 U.S. 350	1954	A delivery truck did not create nexus.
Scripto, Inc. v. Carson, 362 U.S. 207	1960	Having “brokers” in a state-created nexus.
National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753	1967	Simply sending catalogs to a state did not create nexus. Also, something to keep in mind, it stated how burdensome this would be for businesses to have to collect the use tax for every taxing jurisdiction.
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274	1977	Although hinted at in earlier cases, stated nexus (among 3 other factors) was key in determining if a business had to collect the use tax.
Quill Corp. v. North Dakota, 504 U.S. 298	1992	A company must have a physical presence in the state to collect nexus.
South Dakota v. Wayfair Inc., et al., 585 U.S.___	2018	Physical presence is no longer required for nexus. Economic presence can now be used.

State Efforts

While most state efforts to collect the use tax have focused on defining nexus in their state, states have tried other measures over the years with little success. For example, numerous

[6] Replace “catalogue sales” with “internet sales,” and states would present the same arguments approximately 20 years later.

states put a line item on their state tax returns for individuals to voluntarily report out-of-state purchases. Or, even simpler, the state just calculated a use tax owed amount based on income level if an individual opted to report they had made out-of-state purchases. States even have tried to offer amnesty by waiving penalties for past violations if individuals agreed to pay all unpaid use taxes (Bishop-Henchman 2011). None of these measures worked to any great degree.

There has been one major effort that has helped – the *Streamlined Sales and Use Tax Agreement*.

Streamlined Sales and Use Tax Agreement (SSUTA)

Initiated by state governments, the Streamlined State Tax project began in March 2000 because of Congressional attempts to prevent states from collecting sales and use tax on internet sales. The purpose of the project was to simplify and modernize the sales and use tax system. The SSUTA emerged from the project and became effective on October 1, 2005. As stated by the Streamlined Sales Tax Governing Board, the goal of the SSUTA is "to provide states and the business community with a Streamlined Sales Tax System" (SSTGB 2021) It is proposed that the system be funded by member states. Key features of the system are:

- Uniform definitions of sales and use tax terms
- Tax rate simplification
- State-level administration
- Uniform tax bases
- Uniform sourcing rules

Under the SSUTA, member states must utilize common definitions of terms in sales and use tax statutes. This feature ensures common terminology from state to state. To reduce compliance costs, member states must provide free software to businesses for filing and remitting taxes. Member states may have only one state sales and use tax rate for items, with limited exceptions (e.g., tax rates on food). Local jurisdictions of member states are subject to the same rule. Under the agreement, there is one state-level tax agency responsible for the collection of sales and use tax. Buyers and sellers register (and file) only with the agency. The agency also is responsible for the collection and distribution of local jurisdiction sales and use taxes. Local jurisdictions within member states are required to tax and exempt the same goods. Lastly, the SSUTA provides rules on which a jurisdiction can impose a tax on a transaction. Currently, twenty-three states have fully adopted the SSUTA. Table 2 provides a categorization of state participation in the SSUTA.

Table 3

Categorization of State Participation in the SSUTA

Full Member States[1]			Associate Member States[2]		Non-Member States[3]	
Arkansas	Georgia		Tennessee		Alabama	Alaska*
Indiana	Iowa				Arizona	California
Kansas	Kentucky				Colorado	Connecticut
Michigan	Minnesota				Delaware*	District of Columbia
Nebraska	Nevada				Florida	Hawaii
New Jersey	North Carolina				Idaho	Illinois
North Dakota	Ohio				Louisiana	Maine
Oklahoma	Rhode Island				Maryland	Massachusetts

South Dakota	Utah				Mississippi	Missouri
Vermont	Washington				Montana*	New Hampshire*
West Virginia	Wisconsin				New Mexico	New York
Wyoming					Oregon*	Pennsylvania
					South Carolina	Texas
					Virginia	

[1]Full member states comply with the SSUTA.
[2]Associate member states are in substantial compliance with the SSUTA, but not each provision as required.
[3]Non-member states are not in substantial compliance with the SSUTA.
*States with no sales tax.

Federal Legislation (pre-Wayfair)

While there is one more, important, court case to discuss, it is important to lay out other avenues states explored to help in the collection of the use tax. Based on *Quill Corp.*, states have pressed Congress to pass legislation that would help in use tax collection. The two most famous pieces of legislation that have been introduced since 1992 are the *Main Street Fairness Act* and the *Marketplace Fairness Act*. Both pieces of legislation attempt to create a uniform destination-based rule for use tax collection. This means that businesses would have to collect the use tax due from a customer and remit it to the proper state based on where the order is being shipped.

Main Street Fairness Act of 2010 (H.R. 5660)

The *Main Street Fairness Act* (H.R. 5660) originally was introduced in the 111th Congress (2009-2010) by Rep. Bill Delahunt (D-MA). The six co-sponsors of the bill all were Democrats. The bill relied heavily on the SSUTA. Specifically, the *Main Street Fairness Act* said that after 10 states became member states under the SSUTA, then each member state could require any business to collect and remit use (sales) tax sourced to said member state. Sourced, in this case, meant that the customer making the order lived in a member state. It also called for a small business exception, although, in this bill, no dollar amount was given for what constituted a small business. Other parts of the bill included minimum requirements for collection procedures, and called on member states to collaborate with each other to prevent double taxation where a foreign country also had taxing jurisdiction.

The bill was referred to the House Committee on the Judiciary. It went no further. In the 112th Congress (2011-2012), the bill was reintroduced in the House (H.R. 2701) by Rep. John Conyers Jr. (D-MI) and, this time, in the Senate as well (S. 1452) by Sen. Richard Durbin (D-IL). All co-sponsors (10 in the House and 5 in the Senate) were, again, Democrats. H.R. 2701 went to the House Committee on the Judiciary and then to the Subcommittee on Courts, Commercial, and Administrative Law. S. 1452 was referred to the Committee on Finance. Neither bill ever got out of committee.

Marketplace Fairness Act

This bill (S. 1832) was introduced in the 112th Congress (2011-2012) and was similar in scope to the *Main Street Fairness Act*. The two pieces of legislation were so similar that the names are used interchangeably. Both bills use a destination-based structure to tax internet sales,

allowed member states under SSUTA to require all sellers to collect and remit the use tax, and had a small seller exception.

There were, however, differences between the two bills. First, a Republican, Sen. Michael Enzi (R-WY), introduced the *Marketplace Fairness Act*, and it had bipartisan support, with 21 co-sponsors (4 Republicans and 17 Democrats). Further, the bill quantified the small seller exception as gross receipts not exceeding $500,000. Finally, and perhaps most importantly, it gave states that were not member states under SSUTA an opportunity to collect the use tax if they adopted minimum simplification requirements. This simplification included a single-use tax rate and a single, state-level agency to administer the sales and use tax laws.

Despite the bipartisan support, it did not fare much better than the *Main Street Fairness Act* when first introduced, and died in the Committee on Finance. Despite the initial setback, Sen. Enzi persisted and introduced similar bills in the 113th Congress (S. 743, S. 2609, S. 336). S. 2609, in addition to the *Marketplace Fairness Act*, also attempted to extend the *Internet Tax Freedom Act*[7] until November 1st, 2024. It was S. 743 that would become the most well-known of the group.

At first glance, one probably would assume S. 743 was destined to die in committee like every other attempt to pass federal law on use tax collection. It did increase the small business exception to $1,000,000 of gross receipts, but, essentially, was identical to his earlier bills. It did have 29 co-sponsors (6 Republicans, 22 Democrats, and 1 Independent). Despite the past setbacks and slight changes, on May 6th, 2013, S. 743 passed the Senate with a vote of 69-27.

The victory for use tax collection proponents was short-lived. Although it did garner national news coverage and went from the House Committee on the Judiciary to the Subcommittee on Regulatory Reform, Commercial and Antitrust Law, it never made it to the floor of the House for a vote. Earlier in the 113th Congress, Rep. Steve Womack (R-AR) tried to introduce the *Marketplace Fairness Act* to the House (H.R. 684). It never made it out of the Subcommittee on Regulatory Reform, Commercial and Antitrust Law. The bill was reintroduced in 2015 and 2017, but did not pass.

South Dakota v. Wayfair Inc., et al., 585 U.S.___ (2018)

In March 2016, South Dakota enacted S.B. 106 requiring out-of-state sellers to collect and remit South Dakota sales tax on sales of goods or services into South Dakota if, in the previous or current calendar year, the seller's sales into South Dakota exceed $100,000, or the seller had 200 or more separate transactions into the State. S.B. 106 is effectively a direct challenge to the physical presence rule of *Quill Corp.* and *National Bellas Hess, Inc.*

As a result of S.B. 106, South Dakota filed a lawsuit against top online retailers (Wayfair Inc., Overstock.com, Inc., and Newegg, Inc.) for failing to comply with S.B. 106. These retailers did not have employees or real estate in South Dakota (i.e., no nexus, as it previously had been defined). Following *Quill Corp.,* the South Dakota State Trial Court and State Supreme Court ruled in favor of the retailers. South Dakota appealed to the Supreme Court, and certiorari was granted. On June 21, 2018, the Supreme Court ruled in favor of South Dakota and upheld S.B. 106. The Supreme Court concluded that the physical presence rule of *Quill Corp.* is "unsound and incorrect," effectively overruling *Quill Corp.* and *National Bellas Hess Inc*. Without the physical presence rule of *Quill Corp.* and *National Bellas Hess Inc.*, the Court concluded that the

[7] The *Internet Tax Freedom Act* (P.L. 105-227) prohibits state and local governments from taxing internet access and from imposing multiple or discriminatory taxes on internet commerce. The first rule prevents multiple jurisdictions from taxing the same transaction (unless a credit is given). The second rule prohibits imposing different tax rates on goods purchased electronically than on goods purchased at a physical store.

substantial nexus requirement of the *Complete Auto Transit, Inc*. decision (based on activity rather than physical presence) was satisfied in the South Dakota case. This decision effectively ended *Quill Corp.* as a controlling precedent on the issue of Commerce Clause limitations on interstate collections of sales and use taxes.

Note that there are other aspects of the Commerce Clause doctrine that might invalidate S.B. 106, i.e., the principles that protect against any undue burden on interstate commerce. These issues were not litigated, and the Court did not rule on the issues. In this case, however, S.B. 106 includes features that are designed to prevent discrimination against or undue burdens upon interstate commerce. First, the Act applies a safe harbor to businesses with limited activity in South Dakota. Second, the Act ensures that sales tax collection is not applied retroactively. Third, South Dakota provides sellers access to sales tax administration software paid for by the State, and sellers who use the software will be immune from audit liability. Finally, South Dakota has adopted the Streamlined Sales and Use Tax Agreement (SSUTA), which standardizes taxes to reduce administrative and compliance costs. Since the *Wayfair* decision, all states that collect the use tax have adopted a form of economic nexus (e.g., sales dollars, transactions, or both) to force out-of-state vendors to collect the use tax on purchases.[8]

Cases (post-Wayfair)

To date, the Supreme Court has not granted certiorari to a use tax (or sales tax) related case after the *Wayfair* decision. While states have implemented new laws following the *Wayfair* decision, no legal challenges have progressed through the courts (JOA, 2022). However, a challenge to Louisiana's sales and use tax requirements was filed in the District Court for the Eastern District of Louisiana. In *Halstead Bead Inc. v. Lewis*, the plaintiff, Halstead Bead, sells jewelry-making supplies through the internet. The company alleges the laws of Louisiana represent on undue burden on interstate commerce and violate due process. The district court dismissed the case due to lack of jurisdiction and, to date, the plaintiff has not refiled the case in state court.

Federal Legislation (post-Wayfair)

Since the Supreme Court decision on *Wayfair*, there have been several federal legislation proposals. Most of these proposals attempted to limit the states' authority to require tax collections by remote sellers. None of the bills passed the House or Senate committees.

Protecting Businesses from Burdensome Compliance Cost Act (H.R. 6724 in 2018 and H.R. 379 in 2019)

Representative Bob Gibbs (R-OH) first introduced this bill in the House Judiciary Committee in September 2018. This bill prohibits states from imposing sales tax collections by remote sellers on transactions that occur before the bill takes effect, requires a uniform sales tax rate that may not exceed the combined state and local taxes, prohibits states from requiring sellers to remit taxes to more than one location, and prohibits states from requiring remote sellers to provide information about the purchaser beyond the zip code of the purchase and the total amount of fees or taxes collected in a particular zip code. The bill was reintroduced in the House Judiciary Committee in 2019 as H.R. 379, but did not pass the Committee.

Online Sales Simplicity and Small Business Relief Act (H.R. 6824 and S. 3725 in 2018; and H.R. 1933 and S. 2350 in 2019)

In September 2018, Representative James Sensenbrenner (R-WI) introduced H.R. 6824 in the House Judiciary Committee. A similar bill (S. 3725) was introduced in the Senate Finance Committee by Senator Jeanne Shaheen (D-NH). These bills prohibit states from imposing a sales

[8] Missouri was the last state to do so. They passed their version of economic nexus in May 2021 (Russell 2021).

tax collection duty on transactions before June 18, 2018, and impose sales tax collection by remote sellers only on transactions that occurred after January 1, 2019. These bills also prohibit states from imposing sales tax collection on small businesses (with less than $10 million gross annual receipts in the U.S.) and require states to develop an interstate compact on remote sales tax, which must be approved by Congress. These bills did not pass either the House or the Senate.

In 2019, Representative James Sensenbrenner (R-WI) and Senator Jeanne Shaheen (D-NH) reintroduced the bills in the House Judiciary Committee and the Senate, respectively. Again, the bills did not advance in either Committee.

No Retroactive Online Taxation Act of 2018 (H.R. 7184)

In November 2018, Representative James Sensenbrenner (R-WI) introduced this bill in the House Judiciary Committee. This bill prohibits retroactive remote sales tax collection on transactions that occurred before June 21, 2018. This bill also did not pass out of the Committee.

Stop Taxing Our Potential Act (S. 3180 in 2018; S. 128 and H.R. 5515 in 2019)

In January 2019, Senator Jon Tester (D-MT) introduced this bill in the Senate Committee on Finance. This bill was first introduced as S. 3180 in June 2018 and failed. An identical bill, H.R. 5515, was introduced in the House Judiciary Committee by Representative Ann M. Kuster (D-NH) in December 2019, and was subsequently referred to the Subcommittee on Antitrust, Commercial, and Administrative Law in January 2020.

This bill prohibits states from requiring a seller to collect taxes unless there is a physical presence. The bill further defines what constitutes "physical presence." In addition, this bill specifies that the U.S. district courts have the original jurisdiction over civil actions to enforce this bill.

Conclusion

The use tax and its complement, the sales tax, are a significant burden on businesses. The costs of these taxes have been estimated at $2,000,000,000 per year. These costs include software and compliance. While the intent of the SSUTA is to reduce these costs, only 23 states fully participate in the agreement. For accounting professionals, a clear understanding of their client's business is necessary to comply with these taxes. This understanding includes knowing the questions:

- What does a client sell, and where it is sold?
- What services are provided post sale?
- Where is inventory stored?
- Where do employees work?
- For the states in which the client has sales, what are the nexus thresholds and tax exemptions?
- What are the sales thresholds for taxation?
- How compliant is the client, and what steps are necessary to make the client compliant with state reporting requirements?

Although it would seem the long fight over the use-tax collection would have ended with the *Wayfair* decision, the attempts at federal legislation since indicate that is not the case. Consumers and retailers alike have fought paying and collecting use tax since its inception almost 100 years ago. That is unlikely to change. Key questions remain:

- Will the collection programming become simple enough for all out-of-state vendors, regardless of size, to collect the use tax?

- Will there be enough support for Congress to eventually enact a federal law? What would the law look like?
- Will all states, especially those with low or zero sales tax, cooperate in making sure their businesses collect the use tax for a different state?
- Will *Wayfair* encourage businesses to invent creative ways to avoid collecting?
- How will the use tax interact with the growing number of states that are legalizing marijuana? [9]
- How will purchases using cryptocurrencies impact the calculation and collection of use taxes?

The answers to the questions likely will create more questions. The use tax itself has had a unique story since its inception, especially when compared to its older complement, the sales tax. Although the authors of this paper make no predictions as to what will happen, we all hope the use tax is still around in another 90 years for our children (or more likely, grandchildren) to write a follow-up article.

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[9] Several U.S. states have legalized marijuana for personal and/or medical use. Not all states, though, have legalized it, and marijuana remains illegal at the federal level. All states that have legalized marijuana have created an excise tax on marijuana sales.

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