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An Analysis of Georgia's Economic Nexus Legislation

On May 3, 2018, Gov. Nathan Deal signed House Bill 61, commonly referred to as Georgia's internet sales tax bill, but better described as the "economic nexus" bill. Rather than imposing taxation anew on internet sales, it simply sets economic tests for whether a remote seller of already-taxable goods or services has substantial nexus or presence in the state and is thus obligated to collect and remit sales tax.

Even as the new law was enacted, the state's ability to enforce it remained in question, awaiting the ruling of the U.S. Supreme Court in *South Dakota v. Wayfair, Inc.* (2018), on the enforceability of South Dakota's economic nexus law upon which HB 61 was based. Under existing court precedents, retailers have only been required to collect state sales tax if they had a physical presence in that state, such as an office or distribution center. South Dakota's law and HB 61 replaced this physical presence test with one based on whether the seller has a substantial economic presence. On June 21, the Supreme Court ruled in South Dakota's favor, holding that the physical nexus standard was "unsound and incorrect," and thus cleared the way for its law, and presumably Georgia's, to be enforced.

Georgia's economic nexus law is set to take effect Jan. 1, 2019, and in light of the court's ruling in *Wayfair,* is expected to result in significant revenue gains for the state and for local governments from online sales into Georgia that are currently escaping taxation. Though it is not possible to precisely predict the gains in taxes collected, this report estimates the amount of currently untaxed online sales into the state and, based on plausible assumptions, offers a projected range for the gains that can be reasonably expected over the next several years.

We begin with background on the law itself along with the legal and practical issues around its enforcement, and then turn to estimating the revenue impact. We find that successful enforcement of the law can be expected to produce between $168 million and $285 million of additional sales tax collections for the state in the first full fiscal year (FY) after implementation, FY 2020, and between $132 million and $225 million for local governments in the state.

Background

It is worth noting that HB 61 does not change the amount of taxes owed on remote sales into the state. Under current state law, purchasers of taxable goods owe use tax on those purchases where the seller does not collect sales tax at the time of sale. HB 61 simply shifts the obligation from purchasers to sellers to collect and remit the tax, provided they meet the economic nexus tests in the law. The U.S. Government Accountability Office (2017), in estimating potential state and local revenue gains from expanded authority to collect sales tax from remote sellers, cited a Minnesota legislative study to conclude that use tax collections on business purchases range from 70 to 90 percent of the tax owed across all states with a sales and use tax, but that on consumer purchases, compliance was between zero and 10 percent. Thus, the effect of the law is to enable the state to collect a greater share of what is already owed as use tax, but is not currently being collected.

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Until the U.S. Supreme Court ruling in *Wayfair,* the ability of the state to collect sales tax on remote or online sales had been limited to sellers with a physical presence or nexus in the state, the result of legal precedent set in *National Bellas Hess, Inc. v. Department of Revenue of Ill.* (1967) and upheld in *Quill Corp. v. North Dakota* (1992). However, in light of the growth of e-commerce and technological advancements that make sales tax collection less burdensome for online retailers, and also in consideration of particular aspects of the South Dakota law, the court overturned the physical nexus standard.

The law enacted in HB 61 is substantially similar to the South Dakota law in key respects that were important to the court's ruling – similar, but higher economic nexus thresholds, no retroactivity, etc. – thus, the ruling substantially reduces any legal uncertainty around the enforceability of the new Georgia law. Nevertheless, it is certainly possible that legal challenges, such as to the specific economic nexus thresholds, could arise even given the *Wayfair* ruling. Thus, any estimates of potential gains in sales or use tax collections should be considered in light of that remaining uncertainty. At the very least, challenges could delay the realization of any gains in collections.

Georgia's Economic Nexus Law

HB 61 made two significant changes to Georgia law. First, it adds two subparagraphs to O.C.G.A. §48-8-2(8), defining a dealer for purposes of the state sales and use tax, with obligations to collect and remit the tax, file returns, etc. Together, the added paragraphs define thresholds of business activity, or retail sales, in the state by remote sellers above which the seller would be deemed to have a substantial economic presence in the state, thus obligating them to collect and remit tax to the state. The thresholds, either of which would trigger the obligation, are $250,000 of retail sales or 200 transactions with purchasers in the state in the prior year.

Second, it adds a new subsection to O.C.G.A. §48-8-30, defining a "delivery retailer" as a retailer that is not subject to the collection requirements of a dealer, as defined, but meets the same economic nexus thresholds described above. The law imposes on delivery retailers an obligation to collect and remit sales tax, or alternatively to report to both the Georgia Department of Revenue (DOR) and the purchaser the amount of sales to that purchaser on which use tax may be owed. Such reporting is required annually by Jan. 31 for sales in the prior year to any customer with $500 or more in total purchases from the retailer in the year. The bill also sets forth penalties for failure to send and file such statements.

It is not yet clear, without final regulations or other guidance, whether a significant portion of remote sales into the state would be subject to the latter provision, with its collect-or-report obligation, and not to the former provision's revised dealer definition and collect-and-remit obligation. For purposes of this analysis, we assumed that all remote sellers meeting the $250,000 or 200 transactions threshold would be deemed a dealer, obligated to collect and remit tax. This assumption makes the delivery retailer classification and reporting requirements redundant, with no incremental revenue effect. To the extent that regulations enable some sellers to opt for reporting rather than collecting, the $500 purchaser-level threshold for required reporting would likely reduce the amount of remote sales into the state on which the department could collect tax.

The new law is effective beginning Jan. 1, 2019, and applies to all sales made from that date.

Revenue Analysis Overview

The amount of likely revenue gains cannot be precisely estimated because, in addition to the factors noted above, the amounts of sales by currently untaxed sellers who would reach the economic nexus thresholds are not known. A significant portion of currently untaxed sales may come from sellers who would not be subject to the law's requirements because they do not meet the economic nexus thresholds. In addition, enforcement will require being able to identify remote sellers selling into the state who meet the economic nexus thresholds, but do not voluntarily register with DOR and begin collecting and remitting tax. Finally, to the extent remote sellers fall under the new delivery retailer definition rather than that of a dealer and opt for reporting sales rather than collecting the tax, all the current difficulties of enforcing the use tax will remain.

Nevertheless, the amount of currently untaxed online sales can be estimated within a range, updating and refining the estimates done for fiscal notes on the bill in 2017. Given a few necessarily rough assumptions about the effects of sellers not meeting the economic nexus thresholds and the state's ability to effectively enforce the law in the case of sellers who do, we derived plausible projections of expected revenue gains. Table 1 summarizes these projections for both state and local sales taxes. Details of the analysis and assumptions follow.

Table 1. Projected Revenue Gains from HB 61

($ MILLIONS)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
State:					
High	$125	$285	$322	$360	$398
Low	$72	$168	$195	$225	$259
Local:					
High	$99	$225	$253	$283	$314
Low	$57	$132	$153	$177	$204

Details of Analysis and Assumptions

The potential revenue gains from HB 61 would arise from imposing an obligation to collect and remit tax on out-of-state sellers who, due to physical-nexus rules, were not previously required to collect Georgia sales taxes. This change potentially enables the state to capture sales or use taxes on currently untaxed online and mail-order sales. National estimates of online sales are available and these can be shared down to Georgia, but it is not possible to know what portion of these sales are currently taxed or not taxed in the state. Many online retailers also operate from physical stores and thus may already have physical nexus in the state. Others that do not operate physical stores may have physical nexus in the state arising from distribution centers located here, affiliates with a physical presence, or other old-law nexus triggers. The following summarizes the data and assumptions used in arriving at the estimates of foregone revenues from untaxed online sales, upon which the estimated revenue gains in Table 1 were based.

- The U.S. Census Bureau's Annual Retail Trade Survey estimates U.S. e-commerce retail sales for 2016 at approximately $389.1 billion (U.S. Census Bureau 2018a). Of that amount, the survey estimates approximately $332.7 billion or 85.5 percent is attributable to electronic shopping and mail order houses, NAICS code 4541 (U.S. Census Bureau 2018b).
- More recent estimates are not broken out by type of retailer, but the Census Bureau's estimate of aggregate e-commerce retail sales for the four quarters corresponding to state fiscal year 2017 is approximately $415.5 billion (U.S. Census Bureau 2018c). Assuming the same 85.5 percent share attributable to nonstore retailers, we estimated sales for this subset to have been about $355.2 billion.
- According to research firm Digital Commerce 360, prescription drugs, which are exempt from sales tax in Georgia, account for about $3.3 billion of U.S. online sales by nonstore retail pharmacies in 2017, representing slightly less than 1 percent of total nonstore online sales (Brohan 2018). More significantly, various digital products, such as downloads of pre-written software, music, books and videos, are not currently subject to sales tax in Georgia. Based on data used in the analysis of this exemption for the Georgia Tax Expenditure Report, we estimate that these products account for as much as 4 percent of e-commerce sales. Other consumer items that are exempt, such as food for off-premises consumption, make up smaller shares of nonstore online sales and are considered immaterial to this analysis. Thus, we reduced the national nonstore online sales estimates by 5 percent to account for exempt consumer items.
- For the high estimates, we shared down the resulting national amounts to Georgia based on Georgia's share of U.S. households with internet access, about 3.1 percent as of 2016 according to Census data, resulting in an estimated $10.4 billion of nonstore e-commerce sales in Georgia in FY 2017 (U.S. Census Bureau 2017). For the low estimate, we shared down national figures to Georgia using the Georgia share of national personal consumption expenditures on consumption categories that are generally taxable (Bureau of Economic Analysis 2017). This share, about 2.8 percent by our calculation as of 2016, results in a FY 2017 estimate of Georgia sales by nonstore retailers of about $9.4 billion. Table 2 shows estimates of nonstore e-commerce sales nationally for FY 2014-17 and for the first three quarters of FY 2018 annualized, along with high and low estimates of such sales in Georgia.

Table 2. National and Georgia Nonstore E-commerce Sales, net of Nontaxable Items

($ MILLIONS OR AS NOTED)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018*
National Sales *($ billions)*	$224.9	$254.5	$294.5	$337.5	$390.8
Pct. Change from Prior Yr.		13.1%	15.7%	14.6%	15.8%
Georgia Estimates:					
High	$6,923	$7,833	$9,066	$10,388	$12,030
Low	$6,271	$7,095	$8,212	$9,409	$10,897

* FY 2018 figures are annualized based on data through March 2018.

The Georgia DOR reports that, for FY 2018, the state collected approximately $239.4 million in state sales tax from NAICS code 4541, electronic shopping and mail order retailers, up 19.3 percent over FY 2017. Table 3 shows state sales tax collections for this NAICS code for FY 2014-18, along with the implied taxable sales. From these amounts and the high and low estimates in Table 2, we derived estimates of the amounts of currently taxable sales on which sales tax is not currently being collected.

Table 3. Georgia Sales Tax Collections from NAICS Code 4541 Businesses and Estimated Untaxed Online Sales

($ MILLIONS)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
State Sales Tax	$139.6	$168.4	$190.6	$200.6	$239.4
Pct. Change from Prior Yr.		20.7%	13.2%	5.2%	19.3%
Implied Reported Taxable Sales	$3,489	$4,210	$4,765	$5,014	$5,984
Estimated Untaxed Sales:					
High	$3,434	$3,623	$4,301	$5,373	$6,046
Low	$2,782	$2,885	$3,447	$4,395	$4,913

These untaxed sales estimates, projected to FY 2019-23, represent the pool of sales that may potentially be taxed under HB 61. For the projected periods, we made the following two growth rate assumptions:

- For the high case, we assumed growth of 14.8 percent for FY 2019, roughly the average rate of growth since FY 2014, and then we reduced the assumed growth rate by one percentage point per year to 10.8 percent in FY 2023.
- For the low case, we assumed growth at a rate of 9 percent annually based on long-range growth estimates from Forrester Research (Lindner 2016).

Projected untaxed online sales for FY 2019-23, assuming no HB 61 or Wayfair decision, are provided in Table 4.

Table 4. Projected Untaxed Online Sales Absent HB 61 or Wayfair

($ MILLIONS)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
High	$6,941	$7,899	$8,910	$9,961	$11,037
Low	$5,355	$5,837	$6,363	$6,935	$7,559

Actual revenue gains are likely significantly smaller than implied by these estimated sales volumes due to mitigating factors noted previously.

- Many out-of-state online sellers will likely not reach the in-state sales thresholds of the proposed bill and their sales into the state will remain untaxed. Internet Retailer estimates that firms ranked in its top 1000 online sellers account for 95 percent of global business-to-consumer e-commerce sales (Internet Retailer 2016). Investigation of a sampling of firms in their ranking suggests that U.S. sales for the smallest firms exceeds $10 million annually. Assuming a roughly 3 percent Georgia share, a $10 million sales firm would exceed the economic nexus sales threshold. Thus, for the high case, we assumed only 5 percent of sales would be made by firms falling below the thresholds. For the low case, we assumed 10 percent fall below.
- Uncertainty remains about the state's ability to identify remote sellers who should be collecting sales tax and to enforce the collection obligation once identified. This uncertainty cannot be quantified, but in the interest of being conservative in estimating potential revenue gains, we nonetheless made some assumptions we believe are plausible. For the high case, we assumed only a

small rate of noncompliance at 5 percent of sales to reflect this uncertainty. For the low case, we assumed initially lower compliance at 75 percent, improving by 5 percentage points per year to 95 percent in FY 2023.

Given these assumptions and the Jan. 1, 2019, effective date of the law, incremental sales on which taxes are collected are projected as shown in Table 5. Resulting state and local revenue gains, assuming an effective average local sales tax rate of 3.15 percent[1] are reported in Table 1.

Table 5. Projected Incremental Taxed Sales

($ MILLIONS)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
High	$3,132	$7,129	$8,041	$8,990	$9,961
Low	$1,807	$4,203	$4,867	$5,618	$6,463

Finally, the U.S. Government Accountability Office estimates of November 2017 (GAO-18-114) suggest potential state and local revenue gains for Georgia of $232 million to $367 million as of 2017. Comparable numbers from our analysis for FY 2017 are $212 million to $347 million. The GAO report included estimates of collections from business-to-business e-commerce, but the impact was marginal, and the report did not consider issues of enforcement uncertainty.

Conclusion

HB 61, along with the Supreme Court's Wayfair ruling, substantially changes the legal landscape for remote sellers who do business in Georgia. By changing the nexus standard from a physical presence test to one of substantial economic presence, this new law has the potential to generate significant state and local revenue gains through improved collection of existing tax obligations, though practical questions regarding the implementation of the law do remain.

[1] The population-weighted average local sales tax rate as of Jan. 1, 2018, according to the Tax Foundation.

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