

# Threat Of Sales Tax Overcollection Suits Grows Post-Wayfair

By Kathleen Saunders Gregor, Elizabeth Smith and Stefan Herlitz **Law360** (June 20, 2019)

The U.S. Supreme Court held in *South Dakota v. Wayfair Inc.*[1] that states may require out-of-state sellers that have no physical presence in the state to collect and remit sales tax on sales to customers within their borders as long as they have a “substantial” economic nexus with that state.[2] Since last year’s *Wayfair* decision, almost every state has put in place economic nexus rules that require remote sellers to collect and remit sales tax if they meet certain thresholds, usually based upon the dollar volume of sales into a state and/or the number of transactions into a state.[3]



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This means that out-of-state sellers having no physical presence in those states now (or will soon) need to comply with the vagaries and exceptions of each of those states’ sales tax regimes. Many retailers are scrambling to get into compliance to avoid exposure stemming from state departments of revenue enforcement for undercollection of taxes. But a less obvious, though costly risk looms if retailers collect too much sales tax: private sales tax class action lawsuits seeking refunds of overcollected sales tax.



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## Overview of State Sales Tax Collection Enforcement

There are generally three avenues of sales tax enforcement: state department of revenue audits, suits under state false claims acts and sales tax refund suits (often in the form of a class action).

The first avenue of enforcement — audit by a state department of revenue — is the familiar, traditional method of tax collection. Each state has codified procedures for tax audits and assessments, along with dedicated, professional staff with experience enforcing their jurisdiction’s particular tax laws. Further, most states have dedicated tax tribunals for resolving disputes arising out of audits.[4]



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The second avenue of enforcement, suits under state false claims acts, also known as qui tam suits, allows private individuals to bring lawsuits on behalf of the state and collect a portion of the resulting award, which often includes treble damages.[5] Generally, the state attorney general is given an opportunity to intervene when a private individual pursues such a suit. Most states have some form of a false claims act, typically modeled on the federal False Claims Act.[6] However, while the federal False Claims Act prohibits qui tam suits for violations of the Internal Revenue Code, some states, such as New York, have false claims acts that specifically allow qui tam suits for violations of tax law.[7]

The third avenue of enforcement, suits claiming refunds of overpaid sales tax, is the focus of this article. Sales tax refund suits differ significantly from the prior two actions in that such suits focus on overcollection, rather than undercollection of tax, and the department of

revenue for the state in question is wholly uninvolved in the process. These suits involve private plaintiff customers — often a putative class of plaintiffs — claiming that a seller misapplied state sales tax laws in a manner that resulted in overcollection of state sales tax and demanding a refund of such amounts. While this enforcement method was part of the legal landscape long before the Wayfair decision, Wayfair and states' follow-on legislative and regulatory actions could significantly increase the size of the legal battleground.

### **South Dakota v. Wayfair Opens the Door to Increased Consumer Class Actions for Sales Tax Overcollection**

A preview of the effects Wayfair may have on the proliferation of sales tax class actions can be found in the courtroom woes of LuLaRoe, a multilevel marketing company based in California that sells women's clothing. In 2017, customers filed a putative class action against LuLaRoe in the U.S. District Court for the Western District of Pennsylvania, alleging that LuLaRoe had improperly overcharged sales tax based on the location of the sellers, rather than of the customers.[8]

Before that case was ultimately dismissed, another popped up, this time in Alaska, where customers alleged LuLaRoe charged sales tax to customers residing in tax-free parts of the state.[9] That case, too, was dismissed, but not before LuLaRoe faced yet another sales tax class action lawsuit in New York, where customers allege LuLaRoe improperly charged sales tax on clothing sold for under \$110.[10] Each of these actions focused on a common problem: LuLaRoe's practical difficulties with complying with the thousands of state and local sales tax codes across the nation.[11]

The trouble LuLaRoe has had complying with the multitude of sales tax regimes is somewhat understandable, particularly given that many codes have obscure carve-outs and exceptions.

In New York, for example, an uncut bagel is tax-free, while a cut, toasted, or buttered bagel is taxed, unless the cut bagels are sold in quantity.[12] In Illinois, candy sales are subject to an additional tax on top of the base food tax — but candy containing flour does not count as "candy" in Illinois.[13] In Texas, clothing is generally subject to sales tax, except if the item costs less than \$100, is purchased during an annual three-day back-to-school sales tax holiday and is neither specialized athletic clothing nor an accessory.[14] In Massachusetts, clothing is taxable only for amounts over \$175, but athletic gear "also suitable for everyday use" is tax exempt.[15]

All together, the sheer number of complex — and sometimes arcane — sales tax laws with which online sellers must now comply makes it almost inevitable that somewhere, somehow, they will overwithhold. When that happens, as in the case of LuLaRoe, sellers may become subject to a series of class action refund suits, engaging in a game of legal whack-a-mole across the United States.

Although none of the lawsuits involving LuLaRoe centered on a new requirement for remote sellers to collect and remit sales tax post-Wayfair, the proliferation of these rules, their individual nexus requirements and the unique complexities of each jurisdiction's sales tax system will undoubtedly attract the attention of class action plaintiffs' attorneys in the months to come. And it is worth pointing out that LuLaRoe is not alone in defending against consumer complaints for the overcollection of sales tax: DoorDash Inc.,[16] BJ's Wholesale Club Holdings Inc.,[17] and Costco Wholesale Corp.[18], to name a few, have all faced sales tax overcollection suits in the last year.

## Proposals for Reform

With sales tax overcollection class action lawsuit activity intensifying, so too are calls for reform from business organizations and states. The Council on State Taxation, or COST, a nonprofit trade association representing hundreds of businesses engaged in interstate and international commerce, has adopted the position taken by the American Bar Association's "Transaction Tax Overpayment Model Act," which, with limited exceptions, would make sellers immune from class action lawsuits related to tax collection.[19] Rather, COST and the ABA assert that overcharged individuals should first be required to request a refund from either the seller or the state revenue agency, depending on the relevant state's refund procedures.[20]

The 24 states that have signed on to the Streamlined Sales and Use Tax Agreement have also taken this position.[21] The Streamlined Sales and Use Tax Agreement aims to reduce the burden of sales tax compliance by implementing uniform, simplified definitions, procedures, and rules, including a bar on private sales tax refund lawsuits until the customer has first sought a remedy of applying for a refund from a seller.[22] While the Streamlined Sales and Use Tax Agreement, or SSUTA, is a significant step towards cutting back interstate sales tax complexity, only 31% of U.S. residents live in signatory states.[23] California, Illinois, New York and Texas are not signatories to the SSUTA.[24]

## Conclusion

The full effects of Wayfair are still uncertain as states continue to implement their legislative and regulatory responses. However, we expect that the trend of consumer sales tax class action suits will grow with the proliferation of states' Wayfair regulations and retailers' struggle to keep up with the requirements. In response, more retailers may add class action waivers to their terms of use, as sanctioned by the Supreme Court in *AT&T Mobility LLC v. Concepcion*;<sup>[25]</sup> each of the Wayfair respondents — Wayfair Inc., Overstock.com Inc. and Newegg Inc. — has done so.<sup>[26]</sup> Businesses are also likely to up the pressure on state legislatures to protect them from such suits and demand improvements to the efficiency of sales tax administration, whether by joining the Streamlined Sales and Use Tax Agreement or by instituting their own rules barring private sales tax collection suits.

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[1] *South Dakota v. Wayfair Inc.*, 138 S.Ct. 2080 (2018)

[2] *Id.* at 2099.

[3] "Remote Seller Nexus Chart," Sales Tax Institute, available at <https://www.salestaxinstitute.com/resources/remote-seller-nexus-chart> (last visited May 20, 2019).

[4] "Chart of States with and without State Tax Tribunals" prepared by AICPA State and

Local Tax Technical Resource Panel, available at <https://www.aicpa.org/advocacy/state/downloadabledocuments/chart-of-states-with-and-without-state-tax-tribunals.pdf> (last visited May 20, 2019).

[5] See NY STATE FIN Ch. 56, Art. XIII (New York False Claims Act).

[6] See "State False Claims Act Reviews," available at <https://oig.hhs.gov/fraud/state-false-claims-act-reviews/index.asp> (last visited May 20, 2019).

[7] NY STATE FIN § 189.

[8] Webster v. Llr, Inc., No. 2:17-cv-00225 (W.D. Pa. 2018).

[9] Van v. Llr, Inc. et al., No. 3:18-cv-00197 (D. Alaska 2018).

[10] [Porsch v. Llr, Inc. et al.](#), No. 1:18-cv-09312 (S.D.N.Y. 2018).

[11] For instance, LuLaRoe has explained that, in Alaska, it had ""over collected sales taxes on certain interstate transactions as a result of prior limitations in its sales tax software system." Defendants' Memorandum of Law in Support of Motion to Dismiss Second Amended Class Action Complaint, [Porsch v. Llr, Inc.](#), No. 1:18-cv-09312, (D. Alaska) (Dkt. 44).

[12] Food and Food Products Sold by Food Stores and Similar Establishments, TB-ST-283 (2011).

[13] Compare [IL ST CH 35 § 120/2-10](#) (candy does not benefit from reduced tax rate for food to be consumed off-premises) to [86 IL ADC 130.310\(d\)\(7\)](#) (an item is not "candy" if it contains flour).

[14] [TX TAX § 151.326](#).

[15] [M.G.L.A. 64H § 6\(k\)](#).

[16] Moore v. DoorDash, No. 1:19-cv-00636 (D. Del 2019).

[17] BJ's Wholesale Club, Inc. v. Bugliaro, 2019 WL 2017467 (Fla. Dist. Ct. App. 2019).

[18] [Littlejohn v. Costco Wholesale Corp.](#), 25 Cal.App.5th 251 (2018).

[19] Council on State Taxation Final Policy Statement, "Class Action Suits Should Exclude State and Local Transaction Taxes, available at <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/cost-class-action-policy-statement-final.pdf> (last visited on May 20, 2019).

[20] Id.

[21] Streamlined Sales Tax Governing Board, Inc., "State Information" page, listing member states, available at <https://www.streamlinedsalestax.org/Shared-Pages/State-Detail> (last visited May 20, 2019).

[22] "Streamlined Sales and Use Tax Agreement" at Section 325, available at <https://www.streamlinedsalestax.org/docs/default-source/agreement/ssuta/ssuta-as->

amended-2018-12-14.pdf?sfvrsn=8a83c020\_6, (last visited May 20, 2019).

[23] Streamlined Sales Tax Governing Board, Inc., "About Us," <https://www.streamlinedsalestax.org/about-us/about-sstgb> (last visited May 22, 2019).

[24] Streamlined Sales Tax Governing Board, Inc., "State Detail, " <https://www.streamlinedsalestax.org/Shared-Pages/State-Detail> (last visited May 22, 2019).

[25] **AT&T Mobility LLC v. Concepcion** , 563 U.S. 333, 352 (2011).

[26] Wayfair's "Terms of Use," available at [https://www.wayfair.com/customerservice/general\\_info.php#terms](https://www.wayfair.com/customerservice/general_info.php#terms) (last visited May 22, 2019); Overstock.com's "Terms and Conditions," available at <https://help.overstock.com/help/s/article/TERMS-AND-CONDITIONS> (last visited May 22, 2019); Newegg's "General Terms and Conditions," available at <https://www.newegg.com/d/Info/TermsAndConditions> (last visited May 22, 2019).