ALABAMA TAX TRIBUNAL

NEWEGG, INC.,	§	
Taxpayer,	§	DOCKET NO. S. 16-613-JP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Department's Motion to Hold Appeal in Abeyance

In 2015, the Alabama Department of Revenue adopted an administrative rule that requires certain out-of-state sellers to collect and remit use tax on their sales of tangible personal property into Alabama. *See* Ala. Admin. Code r. 810-6-2-.90.03. As a threshold matter, the rule applies only to "out-of-state sellers who lack an Alabama physical presence but who are making retail sales of tangible personal property into the state. . ." r. 810-6-2-.90.03(1). The rule narrows its focus even further by limiting its application to sellers (a) whose retail sales into this state exceed $250,000 per year based on the previous calendar year's sales, and (b) who conduct at least one of the activities described in Ala. Code § 40-23-68. *See* r. 810-6-2-.90.03(1)(a) and (b). Sellers who meet the terms of the rule are considered by the Revenue Department to "have a substantial economic presence in Alabama for sales and use tax purposes," and thus are required to collect use tax and remit the tax to this state. *See* r. 810-6-2-.90.03(1). The rule applies to transactions occurring on or after January 1, 2016.

On May 12, 2016, the Revenue Department entered a final assessment of seller's use tax against Newegg, Inc., for the months of January and February 2016. The

assessment totaled $186,791.45, consisting of nearly $155,000 in tax, $1,000 in interest, and nearly $31,000 in penalties (for Newegg's failure to timely file a return and failure to timely pay the tax claimed due).

Following Newegg's filing of its Notice of Appeal, the Department requested that Newegg produce certain information to the Department through informal discovery. Subsequently, both parties designated expert witnesses, deposed each other's designated experts, submitted stipulations of fact, filed motions to exclude the reports and testimony of each other's experts, and submitted briefs.

On January 12, 2018, the United States Supreme Court agreed to review *South Dakota v. Wayfair, Inc., et al.*, in which the State of South Dakota has requested the court to overturn its decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). Two weeks later, the Revenue Department requested the Tax Tribunal to hold this appeal of Newegg in abeyance, pending a decision by the U.S. Supreme Court in *South Dakota*. Newegg, which also is a party in the *South Dakota* case, opposes the Department's request.

As stated, the Revenue Department's rule, by its own terms, applies only to certain sellers who conduct at least one of the activities listed in § 40-23-68. That statute subjects retailers of items that are stored, used, or consumed in Alabama to Alabama's use tax laws, if the retailer engages in at least one of ten enumerated activities.

Here, the Revenue Department claimed in its Answer that Newegg conducted two of those activities. According to the Department, Newegg "[m]aintains any other contact with this state that would allow this state to require the seller to collect and remit the tax due under the provisions of the Constitution and laws of the United States" ((b)(9)), and

Newegg "[d]istributes catalogs or other advertising matter and by reason thereof receives and accepts orders from residents within the State of Alabama" ((b)(10)).

Concerning (b)(9), however, the Revenue Department also states the following: "The authority of the state under the United States Constitution to require Newegg to collect and remit use tax on sales of tangible personal property into the state is admittedly dependent on the overturning of Quill." Obviously, that statement undercuts the Department's claim that Newegg conducts activities which come within the scope of (b)(9). More specifically, if the Department's position concerning (b)(9) is predicated on the possibility of a future event (the overturning of *Quill*), then the Department automatically acknowledges that Newegg's activities do not come within the scope of (b)(9). In other words, if Newegg's activities during the assessment period fit within (b)(9), then the overturning of *Quill* would not be necessary. Therefore, the Revenue Department's position on (b)(9) is self-defeating.

Concerning (b)(10), which lists the distribution of catalogs or other advertising matter, Newegg claims that the Department's assertion as to Newegg conducting these activities is factually incorrect. If Newegg is correct, then (b)(10) is inapplicable (as is (b)(9)) and, therefore, an essential element of the Department's rule would be missing; *i.e.*, that a seller must conduct at least one of the activities listed in § 40-23-68. And if the essential element of § 40-23-68 is missing, then the rule, by its own terms, does not apply to Newegg here, in which case the fate of *Quill* would be irrelevant to the final assessment at issue.

Therefore, the Department's motion to hold this appeal in abeyance pending a decision in *South Dakota* is denied.

Newegg's Motions to Exclude Expert Reports and Testimony

As stated, both parties designated expert witnesses concerning the parties' respective positions in this case. On November 9, 2017, Newegg filed motions to exclude the reports and testimony of the two individuals whom the Department had designated as experts. In short, Newegg argues that the reports and testimony are not relevant to the issues before the Tribunal.

In § 40-2B-2(k)(4), the legislature stated that the "Tax Tribunal shall admit relevant evidence, including hearsay, if it is probative of a material fact in controversy. The Alabama Tax Tribunal shall exclude irrelevant and unduly repetitious evidence." The Tribunal allowed the Department to respond to Newegg's motions, but the Tribunal directed the Department to answer the following question: "Having stipulated that the Taxpayer has no physical presence in Alabama (Factual Stipulations, ¶ 10), how are the opinions of the Department's experts relevant to, and probative of, any material facts that are in controversy before the Tribunal?"

In response, the Department stated the following:

> In this case, the Department seeks to show that the physical presence standard in Quill has become unworkable and outdated and that it has a significant impact on the state's ability to collect sales and use tax. To make these showings, it is necessary for the Department to create a factual record using the testimony and opinions of its experts.
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> Dr. Fox's expert report and testimony is focused on the losses incurred by the state because of the Quill physical presence rule. See Exhibit A. Dr. Fox's testimony demonstrates the increasing amount of sales made into Alabama by remote sellers and the corresponding increase in the amount of

> sales and use tax that the state is not able to collect because of the Quill physical presence rule. As such, Dr. Fox's testimony is directly related to the changes in the economy and consumer behavior that demonstrate why the Quill physical presence rule is unworkable in today's economy. Factual testimony demonstrating that the Quill physical presence standard has become unworkable is key to demonstrating that it should be overruled. See Montejo v. Louisiana, 556 U.S. 778, 792 (2009) (citing Payne v. Tennessee, 501 U.S. 808, 827 (1991) ("[T]he fact that a decision has proved 'unworkable' is a traditional ground for overruling it.")).
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> Through Dr. Erard's expert opinion and testimony, the Department seeks to show that any compliance costs incurred by remote sellers will be proportional to those currently borne by in-state retailers. See Exhibit B. In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), and its progeny, the United States Supreme Court established a four-part test to determine whether the imposition of a state tax meets the requirements of the Commerce Clause. The third part of the four-part test asks whether the tax discriminates against interstate commerce in favor of in-state commerce. Quill, 504 U.S. 298, 311 (1992). Therefore, factual testimony demonstrating that remote sellers will not incur a disproportionate burden is necessary to show that the Department's rule does not discriminate against interstate commerce. Dr. Erard's testimony is necessary to show that discarding the Quill physical presence rule, and the resulting sales and use tax collection requirements, will not result in a disproportionate burden on remote sellers compared to in-state sellers.
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> The factual record must be created at the trial level; otherwise, later appellate courts will not have any record to review and no basis on which to make a determination whether the Quill physical presence standard has become unworkable and, thus, should be overruled.

In the Alabama Taxpayers' Bill of Rights and Uniform Revenue Procedures Act, our legislature stated: "A taxpayer may appeal to the Alabama Tax Tribunal from any final assessment entered by the department by filing a notice of appeal with the Alabama Tax Tribunal . . ., and the appeal, if timely filed, shall proceed as herein provided in Chapter 2B for appeals to the Alabama Tax Tribunal." § 40-2A-7(b)(5)a. Then, in § 40-2B-2(a), the legislature stated that "[a] tax tribunal hearing shall be commenced by the filing of a notice of appeal protesting a tax determination made by the Department of Revenue. . ." Further,

a taxpayer's notice of appeal "shall identify the final assessment, denied refund, or other act or refusal to act by the department which is the subject of the appeal. . ." § 40-2B-2(h)(1). And the decision of the Tax Tribunal "shall finally decide the matters in controversy, unless any party to the matter timely appeals the decision as provided in this chapter." § 40-2B-2(l)(4).

Here, the Revenue Department's act or tax determination which Newegg is protesting obviously is the entry of the final assessment. It is that assessment which is the "subject of the appeal;" *i.e.*, the "matter in controversy." The matter in controversy is not whether *Quill's* physical-presence standard is now unworkable. Instead, simply put, the matter in controversy is whether the Department's assessment is correct as a matter of law and fact concerning the periods of January and February 2016. *See*, *e.g.* § 40-2A-7(b)(5)d.1., providing that the "Tax Tribunal, circuit court, or the appellate court on appeal may increase or decrease the assessment to reflect the correct amount due."

Thus, the ruling on Newegg's motions to exclude turns on whether the asserted unworkability of *Quill* is a material fact in controversy. Clearly, it is not. Again, any material facts in controversy in this appeal would relate to the periods of January and February 2016. Rightly or wrongly, *Quill's* physical-presence standard was then, and still is, the law of the land concerning the sales and use tax obligations of remote sellers. Consequently, the opinions of the Department's designated experts are not relevant to, or probative of, a material fact in controversy. Newegg's motions to exclude are granted.

The Department's Motion to Strike Affidavit

In December 2017, the Revenue Department requested that an affidavit which had

been included as an exhibit to Newegg's opening brief be stricken, along with the portions of the brief which referenced the affidavit.[1] The basis of the Department's motion is that Newegg failed to follow the procedures in Ala. Admin. Code r. 887-X-1-.5 concerning the submission of affidavits in lieu of testimony.

The rule cited by the Department, entitled "Rules of Evidence," grants a Tax Tribunal judge "discretion to allow sworn affidavits in lieu of testimony. . ." However, concerning an employee of a party, an affidavit is "admissible in lieu of testimony only upon a showing that (1) the affiant is unavailable due to death or then existing physical or mental illness or infirmity, or (2) requiring the affiant's presence at a hearing would be unduly burdensome and that the inability to cross examine the affiant will not unduly prejudice another party to the appeal." Further, the party who intends to submit the affidavit must submit a copy to the Tribunal at least 30 days before the hearing date, and the opposing party then is allowed 10 days to object. But, the affidavit may be allowed without review and approval, "only if, in the discretion of the Tax Tribunal Judge, the opposing party is not unduly or unfairly harmed or prejudiced. . ."

Here, the affidavit at issue was not submitted to the Tribunal for review and approval prior to its inclusion by Newegg in its brief. Thus, according to the Department's reading of the rule, the affidavit and the corresponding portions of Newegg's brief should be stricken. The Department also states the following on page 3 of its motion:

> In addition, the parties agreed to certain stipulated facts for purposes of briefing the Tribunal on the legal issues in the case. Through the affidavit of

[1] The affiant was the Chief Operating Officer of Newegg during the assessment period, and he testified that, among other things, Newegg did not conduct any § 68(b)(10) activities within Alabama during the assessment period.

> Mr. Wu, Newegg seeks to introduce additional factual testimony without having its witness appear at a hearing where he would be subject to cross-examination by the Department. The lack of ability to cross-examine Mr. Wu would seriously prejudice the Department, as it would be left with no ability to challenge Mr. Wu's factual assertions or ascertain whether Mr. Wu had sufficient personal knowledge to make such factual assertions.

Newegg sees things differently, as argued in these excerpts from its Response in Opposition to the Department's Motion to Strike:

> On December 2, 2016, the parties submitted a Joint Proposed Scheduling Order, which provided dates for fact discovery, expert designation, expert discovery, the filing of factual stipulations, and briefing on the merits of the dispute. By order dated December 14, 2016, the Tribunal accepted the proposed schedule. . . The parties were to engage in fact discovery and expert discovery, and then brief the merits for decision by the Tribunal. . . The evident purpose of the briefs was to allow the parties to set out their competing legal positions in light of the facts developed in discovery. If there was no dispute of material fact, the Tribunal would then be in a position to issue a final decision on the merits on the papers.
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> The parties proceeded to litigate the case under that schedule. During the period for fact discovery, the Department chose *not* to depose any fact witness or corporate designee of Newegg, although it had the option and opportunity to do so.
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> . . .
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> On November 13, 2017, Newegg filed its opening brief . . ., supported by the Factual Stipulations and the affidavit of James Wu, who was Chief Operating Officer of Newegg during the Tax Period. . . In his affidavit, Mr. Wu confirmed that Newegg had not engaged in any of the ten categories of activities set out in Section 40-23-68(b). . . That testimony is directly relevant to the legal issue in this proceeding because [the Department's rule], the basis for the Final Assessment, applies only to out-of-state businesses that have *no* physical presence in Alabama, make more than $250,000 in annual sales to residents of the state, *and* engage in one of those ten activities. That is, if Newegg does not engage in any such activity, then the Department does not have the statutory or rule authority to issue an assessment against it. . .
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> On December 6, 2017, the Department filed its Opening Brief on the merits. It did not submit any evidence in support of its positions or in contradiction to the evidence submitted by Newegg.

…

The Department's argument [concerning the affidavit] is based on a cramped and mistaken reading of the applicable Tribunal rules. . . Here, the Tax Tribunal entered the scheduling order discussed above, which provided for fact and expert discovery followed by briefing on the merits.

Although hearings are permitted, they are not required. Specifically, "[t]he Tax Tribunal may … decide a case without a hearing if a party submits information or evidence that is, in the discretion of the Tax Tribunal Judge, sufficient to warrant a final decision in the case." Rule 887-X-1-.4(1). . . The plain language of this rule makes clear that the parties may submit information or evidence to the Tribunal in a manner other than through live testimony at a hearing, and that the Tribunal may, on the basis of that evidence, render a final decision, provided it is found to be sufficient. Indeed, unlike a court, "[t]he Tax Tribunal is not bound by the rules of evidence," and "may, at the discretion of the Tax Tribunal Judge, admit *any* evidence, including hearsay, that is probative and relevant to a material fact in issue." Rule 887-X-1-.5 (emphasis added). That is, nothing in the rules prohibits Newegg from submitting an affidavit in support of a brief provided for by the schedule *to which the parties agreed*.

. . . The Department's citation to Rule 887-X-1-.5 is misplaced because the cited language addresses only the introduction of evidence through the affidavits of witnesses unavailable to appear at a scheduled hearing. Newegg has not submitted the Wu Affidavit in lieu of offering his testimony at a hearing, but in support of a brief set out in the schedule agreed to by the parties for resolving this dispute without one. . . The purpose of that schedule, like the summary judgment procedure applicable under judicial rules of civil procedure, is to permit the Tribunal to determine whether there are any disputed issues of fact, or whether it can render a final decision on the merits based on undisputed facts as contemplated by Rule 887-X-1-.4(1)…

The Department is not the victim of a surprise attack from Newegg, but its own strategic choices. Newegg affirmatively asserted in its reply to the Department's answer, filed on September 29, 2016, well before the scheduling order, that Newegg took the position that it had not engaged in any of the activities enumerated in Section 40-23-68(b) during the Tax Period. With full knowledge that Newegg planned to make this argument, the Department took no steps during fact discovery to develop a record to the contrary. Specifically, it did not depose any Newegg employee or a corporate designee of Newegg (or anyone else) on any topic relevant to Newegg's contacts with Alabama, whether physical, economic, or otherwise. It is no

> surprise that Newegg would introduce evidence in support of its previously stated legal positions; and the Department cannot now claim that it was prejudiced because it made no effort to create a factual record, although it had every opportunity to do so.
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> As the Department's opening brief makes clear, the Department does not have any facts to support its position or that might create, or even imply, a material dispute of fact; the motion to strike is an attempt to use the rules of procedure to create the illusion of such a dispute.

(emphases in original)

As discussed previously in this Order, the Department's rule does not apply unless, among other things, a remote seller conducts at least one of the activities enumerated in § 40-23-68(b). And here, the Department claimed in its Answer to Newegg's Notice of Appeal that Newegg conducted two such activities – those listed in § 68(b)(9) and § 68 (b)(10).

As explained, however, the Department's argument concerning § 68(b)(9) is self-defeating. Concerning § 68(b)(10), the Department stated in its Answer that, "based on its information and belief, the Department asserts that Newegg distributes advertising and promotional materials into the state and receives orders as a result of those advertisements and promotional materials." Also in its Answer, the Department requested informal discovery relating to "[t]he nature and extent of Newegg's contacts with the state and its residents," "[t]he sophistication of Newegg's ability to track customers, orders, and goods," "the current ability of Newegg to collect and remit state sales taxes, and" "[t]he costs incurred by Newegg in collecting state sales taxes."[2] The Department stated that

[2] The Department's request for informal discovery did not require approval or an order by the Tribunal. *Cf.* Ala. Admin. Code r. 887-X-1-.2(3), defining "Formal Discovery" as "[a]ny form of discovery allowed by these regulations that is approved and ordered by a Tax Tribunal Judge." Thus, any informal discovery was handled directly between the parties.

these inquiries "are relevant to whether the state's regulation meets the four-part Complete Auto test and also are relevant to whether the Quill decision remains workable and relevant in the current economy." The Department then proposed that the parties develop and submit a scheduling order for approval by the Tribunal which would address discovery deadlines, expert witnesses, and other matters.

The only other express reference that the Tribunal can find to § 68(b) by the Department is in its brief. There, on pages 7 and 8, the Department refers to Newegg's claim that it does not conduct any of the § 68(b) activities as "a factual question" and as "a question of fact that remains unresolved at this time." In reference to Newegg's use of the affidavit, the Department asserts that Newegg did not follow the Tribunal's rule and that "[a]ny factual evidence should be introduced by witness testimony at a hearing, where the witness will be subject to cross-examination, rather than through a self-serving affidavit. Therefore, these factual issues remain unresolved and cannot be resolved without a hearing." And the Department's only other express reference to § 68(b)(10), besides in its Answer, is in footnote 2 of its brief, where the Department states that subparagraph (b)(10) was not covered by the Stipulations of Fact. The Department did not reassert in its brief that Newegg distributed advertising and promotional materials into Alabama, from which Newegg received orders.

Newegg challenges the assessment on constitutional grounds (that the rule conflicts with *Quill*) and on non-constitutional grounds (concerning the rule's factual requirement). Alabama case law is clear, though, that "courts are reluctant to reach constitutional questions, and should not do so, if the merits of the case can be settled on non-constitutional grounds." *Working v. Jefferson County Election Comm'n*, 2 So.3d 827, 838

(Ala. 2008) (internal citations omitted).

Here, Newegg's non-constitutional challenge concerns § 40-23-68(b)(10); specifically, that it did not conduct any (b)(10) activities in Alabama during the assessment period, and thus that the Department's rule, by its own terms, is inapplicable to Newegg. As stated, the Department's only assertion concerning § 68(b)(10) came in its Answer, based on the Department's "information and belief."

Therefore, the Department is directed to inform the Tribunal of the following:

1) Whether the Department still contends that Newegg conducted the activities described in § 68(b)(10) within Alabama during the assessment period.

2) If the Department's response to 1) is yes, the Department is directed to summarize, with specificity, the evidence that the Department claims supports its contention.

3) Further, if the Department's response to 1) is yes, the Department is directed to explain how its assessment is valid when *Quill's* physical-presence standard is the law currently and when the Department has stipulated that "Newegg lacks a physical presence in Alabama."

The Department's response(s) are due no later than **June 1, 2018**. A ruling on the Department's Motion to Strike Affidavit will be made afterwards.

Entered May 11, 2018.

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JEFF PATTERSON
Chief Judge
Alabama Tax Tribunal

jp:dr
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