



Monumental Shift in Sales Tax Collection Requirements for Remote Retailers

On June 21, 2018, the United States Supreme Court issued its decision in *South Dakota v. Wayfair, Inc.*, overturning a 26 year-old decision holding that a retailer must have a physical presence in a state in order to have a sales or use tax collection obligation. The *Wayfair* decision has an immediate and major impact on retailers of all sizes, but also leaves open numerous unanswered questions.

History

In a 1967 decision, *National Bellas Hess*, the Court held that a state may not constitutionally tax out-of-state businesses who do no more than communicate with customers in the state by mail or common carrier as part of a general interstate business. The Court's 1986 decision in *Complete Auto* departed from this rigid analysis, and held that a state may tax interstate commerce so long as the tax (1) applies to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the state provides. Six years later, in *Quill*, the Court reaffirmed the *National Bellas Hess* physical presence requirement in the context of sales and use taxes, primarily on grounds of *stare decisis*, holding that a retailer must have a physical presence in a state in order to meet the "substantial nexus" requirement of the *Complete Auto* test, and thus have a sales and use tax collection obligation.

In 2016, South Dakota enacted legislation requiring retailers to collect and remit South Dakota sales and use tax if the retailer either (1) delivers more than \$100,000 of goods or services into the state, or (2) engages in 200 or more separate transactions for the delivery of goods or services into the state. The law was a direct challenge to the Court's 1992 decision in *Quill*, requiring a physical presence. The South Dakota courts held the state law was invalid, and the Court granted *certiorari*.

The Court's Decision

The Court held that a physical presence was no longer necessary to satisfy the substantial nexus requirement, casting its prior holding in *Quill* as "flawed on its own terms" and the physical presence rule as "artificial in its entirety." The Court held that the respondents' "economic and virtual contacts" with South Dakota were clearly sufficient to establish substantial nexus in the absence of a physical presence requirement.

The Court stopped short of expressly declaring the South Dakota law valid, as the only issue litigated and briefed was the substantial nexus requirement. However, the Court noted that the South Dakota tax scheme included several features designed to prevent discrimination against or undue burdens on interstate commerce, including (1) the sales thresholds in the law, (2) that the law was not retroactive, and (3) that South Dakota was one of more than 20 states that have adopted the Streamlined Sales and Use Tax Agreement, a uniformity agreement designed to reduce administration and compliance costs for retailers.

Immediate Implications

In abandoning the physical presence requirement, the Court has opened the door for states to impose sales and use tax collection obligations on businesses with no physical presence in the state. Several states have already enacted legislation similar to the South Dakota law, and more are sure to follow. Other states already have laws requiring retailers to collect tax to the fullest extent permitted by the U.S. Constitution. The Court's decision creates an immediate sales and use tax collection obligation in such states for most, if not all, retailers with more than \$100,000 in sales or 200 transactions with in-state consumers.

Unanswered Questions

The Court's opinion offers virtually no guidance for determining what degree of economic or other non-physical presence is sufficient to satisfy the substantial nexus requirement. Is some sales threshold below \$100,000 or 200 transactions sufficient? Is some degree of a mere "virtual" presence sufficient? Would retroactive enforcement of other state's laws be permissible? Could compliance costs and burdens in a non-Streamlined Sales and Use Tax Agreement state give rise to a constitutional infirmity? One or more of issues will likely be the subject of further litigation.

Congress has the ability to step in and enact a nationally required physical presence, sales, or other threshold. But, Congress has failed to act thus far, despite numerous bills having been introduced over the past 15-plus years. With *Wayfair* wreaking havoc on settled expectations, maybe things will change. But until then, remote retailers must grapple with the new world order.

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