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physical presence in a state before that state or its localities could require sales tax collection. A majority of the Court swept aside the rules that guided this area of ...

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On June 21, 2018, the U.S. Supreme Court rendered a decision with broad implications for merchants selling in multiple states. *South Dakota v. Wayfair*, 585 U.S. ___ (2018). In *Wayfair*, the Court rejected the physical presence standard for determining when a remote seller must collect state and local sales (use) tax. This historic change in tax law subjects internet, TV, radio and catalog retailers to collection responsibility for thousands of different state and local sales/use taxes across the country. This decision not only impacts large internet retailers, but also tens of thousands of small to medium retailers, which will be forced to comply with the demands from state and local governments across the country. Small- to midsize

businesses now will be required to determine which goods and services are subject to

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Background

The Commerce Clause of the United States Constitution grants Congress the power to regulate commerce. The U.S. Supreme Court has long construed the “dormant” Commerce Clause as limiting the power of the states to tax transactions occurring in interstate commerce even in the absence of legislation.

In 1992, the Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), concluded that the Due Process clause did not prevent the states from requiring remote sellers to collect the sales tax but affirmed the Commerce Clause holding of *National Bellas Hess*. The rule announced under *Quill* thus continued to limit the ability of the states to require collection of sales tax when the sellers lacked physical presence in the taxing states.

For many years, the states have argued that the rise of internet commerce had fundamentally changed how the United States economy operates. The states sought to limit the effect of the *Quill* decision by statutes to expand the concept of physical presence. Several states enacted statutes that provided that a physical presence existed when affiliates conducted business in the state, or when in-state retailers benefited from the use of non-affiliated websites operated by residents (i.e., “click-through nexus”), or when retailers used apps, cookies or in-state content distribution networks to reach customers.

In 2016, the state of South Dakota passed legislation that eliminated the physical presence standard for “substantial nexus” established in *Quill*, and replaced it with an economic presence standard that would require sellers to collect tax once the seller, on an annual basis, has either 200 separate sales or \$100,000 in sales into South Dakota. The statute did not permit retroactive application while *Quill* still applied.

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- The physical presence requirement creates an arbitrary advantage for remote sellers and discourages in-state development by discouraging in-state presence.
- The Majority does not think that it is right that some minor in-state presence triggers the collection requirement when “pervasive internet presence” does not.
- The Majority concludes that modern e-commerce does not align well with the use of the physical presence standard. The rule should not ignore “substantial virtual connections” with the state.
- The physical presence standard is “an extraordinary imposition ... on state authority.”
- Stare decisis is not enough to continue to apply *Quill* and the “internet revolution” emphasizes the error of *Quill*.
- Reliance interests are not enough to permit “tax avoidance” and small businesses and startups can rely on other aspects of the Commerce Clause for protection, which other protections are described only vaguely.
- Because the particular South Dakota law limits its application to sellers with a “significant quantity of business with the taxing State,” and the particular taxpayers before the Court are large retailers with “extensive virtual presence” in the states, the Commerce Clause does not prevent the states from requiring collection.

Dissent

Chief Justice Roberts agreed that *Quill* was wrongly decided but would have not overturned *Quill* under principles of stare decisis. The Dissent also focused on the role of Congress to set the rules in the area.

Our observations:

- The Majority decision is a broad affirmation of the states' authority to require collection of use tax by remote sellers.

- The Court did not deny that the use tax collection system created burdens on

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Companies have little time to react as many states have already passed laws requiring tax collection by out of state sellers. These companies will be forced to get into immediate compliance, run the risk of audit and penalties from multiple states, or forgo selling into other states.

We will be monitoring the states' responses to *Wayfair* and potential Congressional action to regulate interstate commerce to assist clients in complying with tax responsibilities going forward. For additional information, please contact Ted Bernert, State and Local Tax leader, at 614.462.2687 or tbernert@bakerlaw.com; Chris Swift 216.861.7461 or cswift@bakerlaw.com; Mark Lange at 404.256.6686 or msslange@bakerlaw.com or Kelvin Lawrence at 614.462.2664 or klawrence@bakerlaw.com.

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