

Selling Products Online? U.S. Supreme Court Ruling May Affect Whether or Not You Must Pay State Sales or Use Taxes

Andrew H. Lee

June 28, 2018

On Thursday, June 21, 2018, the U.S. Supreme Court paved the way for states to collect sales or use taxes from sellers with no physical presence in the taxing state by declaring constitutional a South Dakota law requiring out-of-state sellers to remit sales taxes on sales to South Dakota residents if the sellers exceed certain revenue or transaction thresholds. In *South Dakota v. Wayfair, Inc.*, 585 U.S. (2018), the Supreme Court overturned its 1967 decision in *National Bellas Hess, Incorporated v. Illinois*, 386 U.S. 753 (1967) and its 1992 decision in *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992), which had generally prohibited states from collecting sales or use taxes on sales of tangible personal property from sellers with no physical presence within the state. The elimination of the physical presence requirement does not necessarily mean that out-of-state sellers now have substantial nexus with all states, however, and sellers should re-evaluate their tax collection and payment obligations on a state-by-state basis.

Background

Under the U.S. Constitution, a state tax must satisfy the requirements of the Constitution's Due Process and Commerce Clauses, but in recent years it has been the Commerce Clause that has largely shaped restrictions on a state's ability to tax out-of-state businesses. Under the Commerce Clause, there are two primary principles that constrain a state's ability to regulate interstate commerce - the requirement that the state regulation not discriminate against interstate commerce and the requirement that the state regulation not impose undue burdens on interstate commerce.

A number of Supreme Court cases identified the standards that state taxes had to meet to comply with the Commerce Clause. In *National Bellas Hess*, the Supreme Court held that where an out-of-state seller's only contact with a state was the mailing of catalogs and flyers into the state and the shipment of goods into the state via U.S. mail or common carrier, the state could not require the seller to collect the state's use tax. In 1977, the Supreme Court further elaborated on the circumstances under which a state could tax interstate commerce, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). In its *Complete Auto Transit* decision, the Supreme Court indicated that a state tax will survive a challenge under the Commerce Clause if it (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. In the *Quill* decision, the Supreme Court reaffirmed the *National Bellas Hess* physical presence requirement, but clarified

that the requirement arose under the Commerce Clause rather than the Due Process Clause.

Sellers have relied on the *National Bellas Hess* and *Quill* decisions to sell goods to residents of states in which they have no physical presence without collecting or remitting sales or use taxes to those states. The inability of states to collect sales or use taxes from sellers with no physical presence in the states resulted in losses of tax revenue. The rapid growth in e-commerce transactions exacerbated the revenue losses.

States took a number of different approaches to enhance their ability to collect sales and use taxes from out-of-state sellers. Some states adopted rules that caused some out-of-state sellers to be deemed to be physically present in the state, as a result of the activities of certain third parties within the state. Such states attempted to work within the *National Bellas Hess* and *Quill* framework. South Dakota took a different approach and enacted legislation that challenged the validity of the *National Bellas Hess* and *Quill* decisions.

The South Dakota Law

In 2016, South Dakota enacted legislation that required a seller to remit sales tax if, during the current or prior calendar year, (1) the seller's gross revenue from the sale of tangible personal property, any product transferred electronically, or services delivered into South Dakota exceeded \$100,000 or (2) the seller sold tangible personal property, any product transferred electronically, or services for delivery into South Dakota in 200 or more separate transactions. By its own terms, the law was to be applied only after its validity was upheld.

The Supreme Court Decision and its Implications

In the Supreme Court's majority opinion in *Wayfair*, Justice Anthony M. Kennedy wrote that the "physical presence rule of *Quill* is unsound and incorrect." The Supreme Court therefore overruled its *National Bellas Hess* and *Quill* decisions, holding that physical presence was not necessary for there to be substantial nexus, as required by the Supreme Court's *Complete Auto Transit* decision. (The *Complete Auto Transit* decision remains in place and is now, as a practical matter, the governing case in this area.)

The *Wayfair* decision does not necessarily cause sellers to be immediately subject to sales or use taxes in all states that impose them. While the *Wayfair* decision indicates that a lack of physical presence in a state will no longer prevent the state from requiring out-of-state sellers to remit sales and use taxes, the decision does not say that out-of-state sellers must immediately pay sales or use taxes to all states with such taxes. The Supreme Court's decision was influenced by several features of South Dakota's law that appeared to be designed to prevent discrimination against or undue burdens upon interstate commerce. These features were (1) the threshold requirement that the out-of-state seller deliver more than \$100,000 of goods or services into the state or engage in 200 or more separate transactions for the delivery of goods or services into the state per year, (2) the requirement that the payment obligation not be applied retroactively, and (3) South Dakota's adoption of the Streamlined Sales and Use Tax Agreement (the "SSUTA"). (The SSUTA is an agreement among over 20 states to adopt certain consistent rules that are designed to ease the compliance burdens of out-of-state sellers.) It appears that states that have adopted these same features should be able to immediately subject out-of-state sellers to sales or use tax collection and payment obligations.

Steps to Take

It is unclear to what extent a state that has not adopted all of the features of South Dakota's law identified above may subject out-of-state sellers to sales or use tax collection and payment obligations. In particular, it is unclear whether states may impose sales and use tax collection and payment obligations on previously exempt out-of-state sellers retroactively, whether lower sales thresholds may be tolerated, or whether non-SSUTA states may take advantage of the *Wayfair* decision. Sellers that have previously not collected and remitted sales or use taxes because of the *National Bellas Hess* and *Quill* physical presence rule should re-examine their tax collection and payment obligations on a state-by-state basis.

For further information, or if you would like to discuss your sales or use tax collection or payment obligations, please contact:

[Andrew Lee](mailto:alee@kelleydrye.com) (212) 808-7859 alee@kelleydrye.com