

PUBLICATION

Spotlight on SALT: *Wayfair* Decision Broadens E-Commerce Sales Tax Responsibilities

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Last Thursday, the United States Supreme Court issued its much awaited decision in the case of *South Dakota v. Wayfair, Inc., et al.* That decision represents a landmark change in the sales tax collection and remitting responsibilities of all businesses (large or small) involved in selling at retail across state lines by means of e-commerce.

Substantial nexus with a taxing state is one requirement which must be satisfied before that state can impose sales tax collection and remitting responsibilities upon such a business. Deciding whether substantial nexus exists with a taxing state will no longer be based on a 'physical/bricks and mortar' approach. Instead, the extent of a seller's in-state sales activity will be scrutinized using other criteria for purposes of determining substantial nexus.

The Court's *Wayfair* decision, which "overruled" two previous Court decisions with at least 35 years of existing precedent, leaves several unanswered questions and potential unintended consequences. For instance, will some states assert that the *Wayfair* decision allows retroactive application of sales tax responsibilities even though no physical presence previously existed?

Our Firm intends to address some of these questions and explore potential unintended consequences through subsequent alerts and webinars. The scheduling of our first webinar will be announced shortly.

Each out-of-state seller (that is, each e-commerce or remote seller) should consult with its legal counsel in order to carefully evaluate the laws of those states where it is engaged in e-commerce in light of its own facts and circumstances. For now, however, the purpose of this alert is to provide you with some basics.

Wayfair Decision Briefly Summarized

Background. In two earlier Supreme Court decisions interpreting the federal Commerce Clause (namely, *National Bellas Hess, Inc. v. Department of Revenue of Illinois* decided in 1967 and *Quill Corp. v. North Dakota* in 1992), the Court determined that a remote seller lacking any physical presence (such as an employee or building) in the taxing state was not required to collect and remit sales taxes on the retail sale of goods and services to consumers in that taxing state.

Fast forward to the present.

The nature of interstate sales has radically changed since 1992 as a result of e-commerce. During the last several decades, remote sellers have successfully marketed and sold goods and services through the Internet without any need to have an employee or building in the consumer's state. In recent years, an increasing number of reports have documented significant sales tax collection losses by the states. These losses have come as a result of e-commerce sellers, both large and small, who do not maintain a physical presence in the taxing state, thus enabling businesses to avoid responsibilities to collect or remit taxes otherwise due on those sales. Separately, state efforts to collect the corresponding use tax directly from consumers have traditionally proved ineffective and unsuccessful.

Some states suffered so much budgetary pressure that creative efforts have been utilized to support sales tax collections. South Dakota, which has no state income tax and relies substantially on sales tax collections, is one such state. Because of that pressure, South Dakota declared a budgetary emergency in 2016 and enacted legislation requiring e-commerce sellers to collect its sales tax even without physical presence. South Dakota's new statute swept within its jurisdiction all sellers falling under either of two statutory parameters: delivering more than \$100,000 in annual sales of goods or services into South Dakota or engaging in 200 or more separate transactions for delivery into that state during a year.

The Litigation. E-commerce retailers challenged that South Dakota statute in court. That lawsuit reached the U.S. Supreme Court and ultimately was argued before the Court earlier this year. Proponents for the South Dakota statute contended in part that the prior 1992 and 1967 decisions should be overruled because those decisions had inappropriately interpreted the federal Commerce Clause of the U.S. Constitution. Opponents of that South Dakota statute contended in part that abandonment of the physical presence standard as interpreted under the Commerce Clause required action of Congress rather than being judicially determined by the Court.

The Decision. In a 5-4 decision, the Court's majority opinion determined that both the 1992 and 1967 decisions in essence created and fostered a "tax shelter" that gave e-commerce sellers a competitive advantage over in-state brick and mortar retail businesses. The majority ruled that the physical presence rule "must give way" as a result of the far-reaching systematic and structural changes in the economy caused by e-commerce.

The Court thus overruled its two prior decisions, concluding "that the physical presence rule of *Quill* is unsound and incorrect." The Court has remanded the *Wayfair* case to the South Dakota courts to determine whether other provisions of South Dakota's taxing statutes run afoul of the Commerce Clause.

What *Wayfair* Means for Remote Sellers

The *Wayfair* decision is still very fresh and is being analyzed and reviewed. In particular, and because of the Court's remand, the full impact of that decision may not become apparent for quite some time.

Notwithstanding that analysis of the *Wayfair* decision is ongoing and currently there is uncertainty as to its full impact, remote sellers (meaning not only the large, established e-commerce concerns but also any start-up or other business aiming to use the Internet to expand its customer base across various states) must nevertheless evaluate their present situation taking into account many considerations such as the following:

- Particular Facts and Circumstances Are Critical. The facts and circumstances before the Supreme Court regarding the specific remote sellers involved in the *Wayfair* decision, while certainly helpful in understanding the future impact of this decision, are not dispositive of each and every other fact situation – meaning that the particular facts and circumstances of each other e-commerce seller must be independently reviewed and evaluated for numerous possible outcomes. For instance, does the e-commerce seller do business in one or more states that already have laws/rules on their books similar, in whole or in part, to the South Dakota statute considered by the Supreme Court; and, if so, are those states now seeking to actively enforce compliance with their laws/rules either prospectively or retroactively? Any prudent seller must identify the necessary steps to be taken so as to be in compliance with potentially expanded sales tax responsibilities in each such state where sales are made to retail customers. In addition to identifying such compliance steps, an e-commerce merchant should also examine possible planning opportunities for lessening the adverse effect of the *Wayfair* decision.
- Other States May Follow South Dakota. The Court's *Wayfair* decision only addressed the South Dakota statute. That South Dakota statute established parameters requiring a remote seller to have more than \$100,000 of sales or 200 or more separate transactions into that state before becoming

obligated to collect and remit the sales tax. The Supreme Court noted that within these parameters, "nexus is clearly sufficient" to subject a remote seller to collect and remit sales taxes to South Dakota. Every state having a sales tax will undoubtedly seek to review its own laws and rules to determine whether to enact a similar regime to that of South Dakota. Indeed, some states may attempt to subject e-commerce sellers to more aggressive enforcement actions arguably consistent with the ruling in *Wayfair*. All of this means that each remote seller must be vigilant in monitoring, understanding, and, whenever appropriate, complying with the likely evolution of the varying laws and rules in every state where they may sell to consumers. Aside from any statutory or regulatory action undertaken by the various states, Congress could also act so as to better define the sales tax compliance obligations of e-commerce sellers. Should it choose to do so, Congress could either narrow or broaden the reach of the *Wayfair* decision.

- Unanswered Questions and Unintended Consequences. Many questions remain unanswered following the *Wayfair* decision. For instance, can a state constitutionally impose a retroactive application of the tax collection/remittance responsibilities? Because the South Dakota statute did not attempt retroactivity, *Wayfair* provides no clear answer. Similarly, a multitude of unintended consequences may well flow from that decision. An obvious one involves the possibility of inhibiting the growth of start-ups/entrepreneurial companies because of the elimination of the physical presence requirement. Yet another such consequence could well be the sheer expense of complying with hundreds if not thousands of different taxing jurisdictions (state, county, city, district and so forth). Will new tax compliance software and artificial intelligence products ultimately help businesses meet these compliance challenges? Will sales prices simply increase as sellers seek to recover their compliance costs? All these uncertainties mean that e-commerce sellers must therefore remain vigilant to recognize other grounds, aside from physical presence, that may still justify judicial or legislative challenges under the federal Commerce Clause to the new tax regimes that the states may likely seek to impose.

Pertinent Statutory/Rulemaking Efforts in Selected Other States

As just noted, remote sellers need to keep a close eye on the anticipated evolution of existing and future statutory/rulemaking enforcement actions purportedly based upon the *Wayfair* decision. From time to time over the next several months, we will issue additional alerts spotlighting the status of these efforts in selected states across the nation. Our first alert in that regard should be forthcoming within the next ten days.

Summary

We encourage every business involved in e-commerce to consult legal counsel without a delay in order to begin to ascertain the impact of the *Wayfair* decision. That impact may vary greatly depending upon the particular facts and circumstances under which the business operates and the states into which the business is selling goods and services to consumers.

There are a number of important inquiries in ascertaining such impact. One will be to discern, in the context of the federal Commerce Clause, more precisely how far this landmark decision will allow the states to go in trying to ensnare e-commerce retailers in ways that may adversely affect how those retailers maintain and potentially grow their interstate business. Failure by a business to appreciate and understand the contours of the *Wayfair* decision could result in significant exposure.

Baker Donelson stands ready to assist businesses of all sizes in understanding and complying with the new sales tax powers which the *Wayfair* decision has allowed the states to exercise. If you have any questions on how the *Wayfair* decision will affect your business, please contact [Carl Hartley](#), [Stuart Schabes](#), [Ross Cohen](#), or any member of the Firm's [Tax Group](#).