

CLIENT ALERT

Supreme Court Turns the Page on *Quill*

June 22, 2018

On June 21, 2018, the Supreme Court released *South Dakota v. Wayfair, Inc.*, No. 17-494, slip op. (2018), which overturned the physical presence requirement for imposing state sales tax set forth in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). The Court declared *Quill* to be “unsound and incorrect,” and held that the physical presence rule gave out-of-state sellers, particularly online retailers, an arbitrary advantage over their competitors who collect state sales taxes.

A majority of states tax the retail sales of goods and services in their state.¹¹ Sellers are required to collect and remit the tax to the state, but if they do not, in-state consumers are responsible for paying a use tax at the same rate. Nexus is a prerequisite for taxation under the Commerce Clause just as it is under the Due Process Clause. Prior to the Court’s decision in *Wayfair*, the Court had held that the Commerce Clause requires more than the Due Process “minimum contacts” connection; it requires a “substantial nexus.” See *Quill*, 504 U.S. at 313. In *Quill*, the Supreme Court stated that a taxpayer must be physically present in the taxing state for the state to impose tax. Following the Court’s decision in *Wayfair*, physical presence is no longer required for a state to impose sales tax.

The *Wayfair* case arose in 2016 when South Dakota passed a law (the “Act”) requiring all retailers to collect and remit sales tax if they either delivered more than \$100,000 of goods or services into the state or engaged in 200 or more transactions in South Dakota. Relying on this law, South Dakota sued three online retailers for their failure to collect and remit sales tax pursuant to the new law. The retailers convinced the trial court and South Dakota Supreme Court that the law did not meet the physical presence standard set forth in *Quill*, and that the retailers could not be forced to start collecting sales tax. South Dakota petitioned the Supreme Court for review. In a 5-4 decision, the Court overturned the physical presence standard set forth in *Quill*.

This means that online retailers must now comply with the Act, which requires vendors without a physical presence to collect and remit sales and use taxes if they meet certain sales thresholds. Now, rather than requiring physical presence, the first prong of the test to determine whether a state sales tax is valid “simply asks whether the tax applies to an activity with a substantial nexus with the taxing State.” *Wayfair*, slip op. at 22. “[S]uch a nexus is established when the taxpayer [or collector] ‘avails itself of the substantial privilege of carrying on business’ in that jurisdiction.” *Id.* (citing *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1, 11 (2009)).

The Court did leave open the possibility that “some other principle in the Court’s Commerce Clause doctrine might invalidate the Act,” but the Court did not identify or address these principles in *Wayfair*. *Id.* at 23. The Court remanded the case to the South Dakota Supreme Court to consider such issues.

The Court also noted that the Act “forecloses the retroactive application of this requirement [that out-of-state sellers collect and remit sales tax].” *Id.* at 3. “[T]he Act ensures that no obligation to remit the sales tax may be applied retroactively,” which the Court held prevents discrimination against or undue burdens upon interstate commerce. *Id.* at 23. The consequences from prior

noncollection of sales taxes in reliance on *Quill* are yet unknown for jurisdictions other than South Dakota. Justice Roberts, writing for the minority, states that this matter should have been left to Congress because Congress can “provide a nuanced answer to the troubling question whether any change will have retroactive effect.” *Id.* at 7 (Roberts, C.J., dissenting).

The transition from *Quill* to *Wayfair* will not be easy. Except for South Dakota, each of the States, and the District of Columbia, will have to consider what “substantial nexus” will be required for that jurisdiction’s sales tax (if it has one) to apply to a remote seller. Unless Congress acts to impose nationwide rules, we will see a patchwork of rules and increased compliance costs. Moreover, issues related to potential retroactive liability will have to be worked through on a jurisdiction by jurisdiction basis.

¹ The Tax Foundation reports that 45 States and the District of Columbia have a sales tax.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Charles C. Hwang

Partner – Washington, D.C.

Phone: +1.202.624.2626

Email: chwang@crowell.com