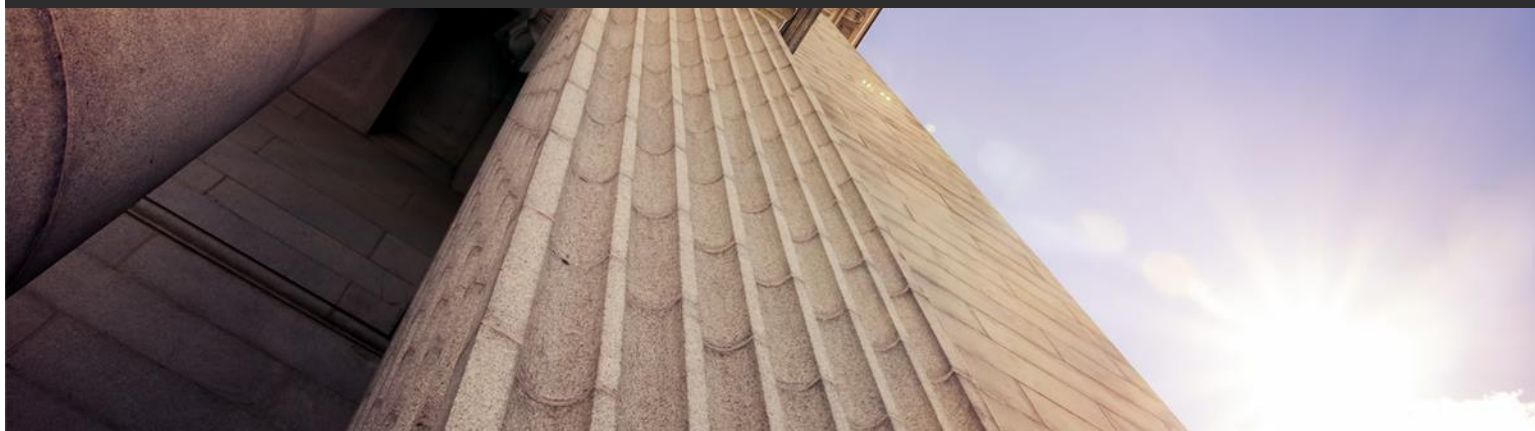


Alert | State & Local Tax



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U.S. Supreme Court to Hear Arguments on Whether Physical Presence is Required for Sales and Use Tax Purposes

U.S. Supreme Court grants certiorari in *South Dakota v. Wayfair, et al.*

The U.S. Supreme Court will review the validity of a South Dakota law which requires remote retailers to collect the state's sales and use tax even if the retailer does not have a physical presence there. If this state law is upheld by the high court, it may result in a tidal wave of similar legislation around the country, requiring online retailers who do not already do so to collect and remit tax and be subject to audits by state and local taxing authorities.

The South Dakota legislature enacted an e-commerce tax bill in 2016 with the intent that it be challenged in order to reverse a U.S. Supreme Court precedent requiring an out-of-state retailer to have a physical presence in a state in order for it to have a sales tax collection obligation there. Several states have sought to assert similar economic nexus positions, including Washington, Wyoming, North Dakota, Maine, Massachusetts, Vermont, Pennsylvania, Indiana, Tennessee, and Connecticut.

The 1992 U.S. Supreme Court case, *Quill v North Dakota*, held that a retailer must have a substantial physical presence in a state before the state can require the retailer to collect its sales tax. This pre-internet era case involved a mail order catalog office supply company. The Court's ruling said that the issue of whether a state can require an out of state retailer to collect its tax is within Congress's power to regulate interstate commerce, but announced the physical presence test in the absence of federal legislation. The Court cited support for its decision based on the diverse and conflicting sales and use tax obligations that would unduly burden interstate commerce if imposed on remote sellers.

In 2015, in a concurring opinion in a case dealing with a procedural question on a challenge to a Colorado e-commerce tax law, Justice Kennedy said that it is time for the Court to revisit *Quill*, since that case was decided in 1992, before the advent of the e-commerce industry. This prompted South Dakota and the other states to enact legislation that squarely contradicts *Quill*'s *physical* presence requirement, in order to mount a legal challenge to be heard by the Supreme Court. Online retailers continue to maintain that the U.S. Supreme Court precedent in *Quill* prevents states from requiring them to collect sales and use tax in the absence of a physical presence within the state.

The South Dakota legislation provides that an internet retailer must collect the state's tax if it has more than 200 sales delivered to customers in the state or more than \$100,000 in sales, without any physical presence requirement. This legislation was passed with full knowledge that it is in direct conflict with *Quill*, with the hopes that it will be challenged in the courts in order to ultimately make its way to the Supreme Court. The South Dakota courts, following *Quill*, held the statute unconstitutional, setting up South Dakota's request to the U.S. Supreme Court to hear its appeal and overturn *Quill*. On Friday Jan. 12, 2018, the U.S. Supreme Court agreed to hear the case of *South Dakota v. Wayfair, et. al.*

Various bills that would have legislatively overturned *Quill* have languished in Congress for 16 years. The most recent – the Marketplace Fairness Act – was passed by the Senate in 2013, but died in the House. The recent rush to pass laws to directly challenge *Quill* reflects frustration by these states of inaction by Congress. It may be that the Court's taking the case will spur action on the part of Congress, but unless Congress enacts legislation or the U.S. Supreme Court decides to overturn *Quill*, the physical presence nexus standard continues to apply.

It is possible that with the potential reversal of the *Quill*'s physical presence requirement by the high court, there might be a move in Congress to enact legislation to preempt the confusion and disruption to online retailing that might result from a reversal. Congress, if it chooses to do so, could regulate these requirements, setting thresholds in the number or volume of sales before an online retailer would be obligated to collect tax, and also requiring reporting only to a central state taxing authority, rather than to multiple local jurisdictions. Consequently, while the eyes of the online retail industry will be focused on the Supreme Court, Congressional action might determine the ultimate fate of this issue, and such action might be accelerated due to the Court's agreement to hear this South Dakota case.

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