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High Court Internet Tax Decision Is a Sales Tax Tsunami for E-Commerce Industry

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When the Supreme Court decided *Quill v. North Dakota,* 26 years ago, a sales tax case involving an office products catalog business, it created barely a ripple in the retail industry. The *Quill* decision held that a remote retailer must have a physical presence in a state before the retailer could be required to collect sales tax. In 1992, e-commerce did not exist, and traditional catalog sales were just a minuscule share of total retail sales. *Quill* is the reason that many online retailers do not collect sales tax on sales to customers in other states. As e-commerce has grown to take a larger and larger share of the total retail market, state legislatures and tax administrators have been busy crafting rules to work-around the physical presence requirement, yet many businesses were nevertheless able to structure their operations to avoid collecting tax on out-of-state sales. On June 21, the Supreme Court released its decision in *South Dakota v. Wayfair*, reversing its *Quill* decision. Unlike the minor ripple to the retail industry caused by the *Quill* decision in 1992, the broad language of the *Wayfair* decision is a sales tax tsunami that will result in changes to the industry.

The *Wayfair* case came about because of a South Dakota law that was enacted specifically to test/challenge *Quill*. The law said that a retailer must collect the state's sales and use tax even if the retailer has no physical presence in the state, as long as it has either a minimum of $100,000 in annual sales to residents of the state, or 200 or more annual sales transactions to residents. The South Dakota Supreme Court ruled that the law was unconstitutional because it violated *Quill*'s physical presence standard. The U.S. Supreme Court agreed to review the *Wayfair* case, and finally answer the question of whether the growth in significance of e-commerce to the retail industry warrant either saying "yes," the *Quill* standard is still valid, or "no," *Quill* is no longer viable in today's online world.

The majority of the court did not simply answer "no" to *Quill*, but rather "hell no!" Instead of reasoning that times and technology have changed dramatically over the 26 years since *Quill* was decided, resulting in the need to make changes to the physical presence requirement, it held that *Quill* was wrongly decided in the first place. In explaining why the doctrine of stare decisis, the ability to rely on prior judicial precedent could not justify maintaining *Quill*, the majority said that stare decisis was not applicable here because online retailers have used the physical presence standard to gain a competitive advantage over their brick and mortar competitors, and that the doctrine of stare decisis does not afford protection where it is used for tax avoidance. "A business is in no position to found a constitutional right on the practical opportunities for tax avoidance" the court wrote, quoting a 1941 case. What's more, the majority opinion did not say whether its decision was only prospective, leaving the possibility that state tax administrators might attempt to enforce the new rule retroactively, embracing the court's tax avoidance language to counter an online retailer's defense that it was relying on a well-established constitutional law precedent. Potential retroactive application could be a concern to online retailers, because many states have had laws on the books for years saying that transactions are subject to sales tax to the extent they are permitted under the U.S. Constitution. In addition, nine states have enacted laws similar to South Dakota's statute, which have effective dates prior to the date of the *Wayfair* case (Alabama, Hawaii, Indiana, Maine, Mississippi, Pennsylvania, Rhode Island, Vermont and Washington). The Hawaii Department of Taxation has announced that it will enforce its law retroactively and instructed online retailers to pay tax on sales going back to Jan. 1, 2018. This might encourage other states to likewise enforce their similar laws retroactively.

Where do things stand now? The Supreme Court held that South Dakota's statute is valid notwithstanding *Quill*, but remanded the case back to the South Dakota Supreme Court for a determination that the statute also satisfies due process and interstate commerce muster under constitutional law; the South Dakota Supreme Court's initial decision merely said that the statute was not valid because of *Quill*. But it is a pretty good bet that the South Dakota justices will uphold the law under other constitutional tests. In the meantime, it is likely that state tax agencies around the country will be very busy sending out assessment notices.

Congress might be spurred into action to put an end to any uncertainty caused by the *Wayfair* decision by enacting legislation setting sales thresholds that must be reached before a retailer is required to collect tax. These kinds of rules would spare small businesses from the burdens of tax compliance, and require uniform tax rules and audit procedures. When *Quill* was decided, the court invited Congress to address the issue of tax on remote sales, but Congress has failed to act. Multiple bills addressing this issue have been introduced over the course of the last two decades. In 2013, the Senate passed the Marketplace Fairness Act, which would require a business with total worldwide sales of more than $1 million to collect tax in every state where it has customers and providing some simplification to online businesses which would have been required to collect tax. That bill failed to get to a vote in the House, with many representatives saying that the $1 million sales threshold was too low, but no action was ever taken in the House to modify the bill to make it more palatable to the Republican majority.

Today, with the vastly different landscape due to the *Wayfair* decision, the online retail industry is likely going to be motivated to seek a federal law, which could resolve several concerns, including the issue of having to comply with thousands of local taxing jurisdictions around the country and different rules in each of the 45 states that impose a sales tax. A federal law could also address the issue of retroactivity, allaying concerns that tax agencies might aggressively pursue taxes for prior years. And states might feel confident enough now with the prospects of additional revenue in the future to agree not to apply the reversal of *Quill* retroactively.

About the Author:

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