CORPORATE, TAX & TRANSACTIONAL ALERT

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Supreme Court Rules That States can Require Out-of-State Retailers to Collect Sales Tax Even if They Have no Physical Presence in the Taxing State

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Since 1992, out-of-state retailers have relied on *Quill Corp. v. North Dakota*, 504 U. S. 298 (1992) ("*Quill*") for the rule that a state could not constitutionally require a retailer to collect sales tax on sales to customers in the state if the retailer had no physical presence in the state. On June 21, 2018, the Supreme Court in *South Dakota v. Wayfair*, 585 U.S. ____ (2018) ("*Wayfair*") overruled the physical presence rule in *Quill*, holding that a retailer with no physical presence in a state may constitutionally be required to collect sales tax on sales to customers in the state if the retailer has a "substantial nexus" with the state, which the Court said could be met by having a sufficient level of economic and virtual contacts with the taxing state.

Wayfair arose from a challenge by several national online retailers to South Dakota's sales tax act (S.106, 2016 Leg. Assembly, 91st Sess. (S.D. 2016)) ("Act"), which requires out-of-state retailers to collect sales tax on sales to South Dakota purchasers if the retailer, on an annual basis, delivers more than $100,000 of goods or services into South Dakota or engages in 200 or more separate transactions for the delivery of goods or services in South Dakota. Each of the retailers in *Wayfair* met the Act's sales and transaction requirements, but none of them had employees or real property in South Dakota. The retailers argued that the Act was unconstitutional under *Quill* because it imposed sales tax liability on retailers who lacked a physical presence in the State. The South Dakota Supreme Court sided with the retailers and South Dakota appealed its decision to the United States Supreme Court asking the Court to overrule *Quill*.

In reaching its decision to overrule *Quill*, the Court reasoned that the physical presence test is outdated based on the enormous growth of online sales in relation to traditional sales since *Quill* was decided and the resulting loss in sales tax revenues in states where online retailers had sales, but no physical presence. The Court illustrated the arbitrariness of the physical presence test as applied to identical in-state and out-of-state online retailers: one with a warehouse in the taxing state and the other with a warehouse in a neighboring state that maintains a virtual showroom on its website. The Court mentioned that, under *Quill*, the first retailer would be subject to a sales tax liability in the taxing state while the retailer from the neighboring state would not. The Court also pointed out the difficulty of applying the physical presence test to modern e-commerce practices affecting consumers in the taxing state, i.e., providing them with access to virtual showrooms on the retailer's website, leaving cookies from the website on their computers, and downloading the retailer's apps to their phones.

After overruling *Quill*, the Court addressed whether the Act applies only to a retailer with a substantial nexus with South Dakota. In answering that question in the affirmative, the Court stated that the nexus was clearly sufficient based on the economic and virtual contacts that the online retailers have with the State, pointing out that the quantity of business required to be subject to the Act could not have occurred unless the retailer availed itself of the substantial privilege of carrying on business in South Dakota.

The Court did not resolve the question of whether the Act discriminated against out-of-state retailers as the parties had not briefed or litigated that issue. Nevertheless, the Court did mention that South Dakota's tax system includes several features designed to prevent discrimination against interstate commerce: a safe harbor to those who transact only limited business in South Dakota, the prospective nature of the Act, South Dakota's being one of more than 20 States that have adopted the Streamlined Sales and Use Tax Agreement which provides uniform definitions and rules, the provision of access to sales tax administration software paid for by the State and immunity from audit liability for those who use such software.

In view of *Wayfair*, it is likely more states will adopt South Dakota's approach and require out-of-state retailers who meet annual sales or transaction standards to collect sales tax on remote sales to customers in their states. It remains to be seen whether some states will adopt lower or different sales or transaction standards than those in the Act. This will require for many online retailers that they update their check-out procedures on their websites to charge sales tax in states where they previously had no duty.

For additional information or assistance with the applicability and effect of this development, please contact any of the listed Roetzel attorneys.

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