

State and Local Tax



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Supreme Court Rules for the States—Physical Presence Not Required for Sales Tax Collection

The Supreme Court ruled today that states may impose a sales tax collection requirement on sellers having no physical presence in the state. This decision will have a significant impact on those online sellers who do not collect state sales taxes because they have no employees or offices outside of their home state.

In a 5-4 decision, the Supreme Court today held that a state may impose a sales tax collection obligation on a seller of taxable products to residents of that state even if the seller has no physical presence in the state.

In *South Dakota v. Wayfair, Inc.*, the court overruled its 1992 holding in *Quill Corp. v. North Dakota*, and its 1967 ruling in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, under which a state could impose a sales tax collection requirement only if the seller had a physical presence in the state; the mere shipment of goods into the state that were ordered online did not provide a sufficient “nexus” to require the seller to collect that state’s sales tax.

The South Dakota statute tested in *Wayfair* requires out-of-state sellers to collect sales tax if the seller annually sells more than \$100,000 in goods or services that are delivered into the state or engages in 200 or more separate transactions for the delivery of goods or services into the state, without regard to physical presence. The Supreme

Court held the Constitution’s Commerce Clause did not require a seller to be physically present in a state to have a substantial nexus that allows the state to impose a tax collection requirement on the seller.

The Supreme Court remanded the case to the South Dakota Supreme Court, which ruled in favor of *Wayfair*, to determine if there were other reasons beyond the lack of the seller’s physical presence that could cause the South Dakota statute to violate the Commerce Clause.

The Supreme Court noted, however, that the South Dakota statute includes several features that were designed to avoid further Commerce Clause challenges, i.e., the less than \$100,000 or 200 transactions “safe harbor” so sellers with only limited business in the state were not required to collect the tax; a non-retroactivity provision that bars the state from enforcing the law for prior sales; and the requirement for a single, state-level administration of the

tax, thereby discounting arguments that the tax is too administratively burdensome to be enforceable.

HOW WILL THE STATES REACT?

We believe the Supreme Court called out the above features of the South Dakota statute designed to avoid a Commerce Clause challenge as a message to the states. That is, to be in the best position to avoid a constitutional challenge, the Supreme Court is suggesting the states may want to adopt the “protections” found in the South Dakota law.

We expect over the next several weeks states with statutes similar to South Dakota’s will issue notices stating their expectations for online sellers; other states will enact statutes similar or identical to South Dakota’s with the Commerce Clause protections suggested by the Supreme Court. Others may take a more aggressive approach, requiring online sellers to register and begin collecting sales tax based on existing statutes that do not include the South Dakota protections.

Please watch our client alerts for further developments on this issue.

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