

Physical Presence of the Seller is No Longer Required for a State to Impose Sales Tax

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The U.S. Supreme Court has struck down a decades-old requirement that a seller must have a physical presence within a state to be required to collect sales tax. The June 21, 2018, opinion in *South Dakota v Wayfair* opens the door for states to establish standards for sellers to collect tax based on a virtual or economic presence that the state considers to be "substantial."

In 1992, the U.S. Supreme Court in *Quill v North Dakota* reaffirmed its previous 1967 decision in *National Bellas Hess v Illinois* establishing a requirement that a seller must have a physical presence to require it to collect that state's sales tax. With the expansion of the internet economy, this requirement has been viewed as increasingly anachronistic. South Dakota enacted a law in 2016 designed to challenge the *Quill* rule providing that a seller with more than \$100,000 in sales or 200 transactions during the year is required to collect sales tax even in the absence of a physical presence. Five justices of the Supreme Court agreed that it was time to overturn *Quill*, finding that the standards of the South Dakota law satisfied the Commerce Clause.

States had already been chipping away at the edges of the *Quill* case by developing creative standards for establishing a physical presence, such as by paying commissions to third parties within the state who attract buyers to a seller's website ("click through" nexus) or placing web "cookies" on user computers. The decision in *Wayfair* does not impact those standards directly, but it now allows a state to have an alternate standard based on sales volume alone.

How will the states react?

The threshold of \$100,000 in sales or 200 transactions is now a bright line that would clearly allow a state to impose a collection requirement. However, the states have to decide if a lesser volume of activity would be sufficient; for instance, would \$50,000 or 100 sales be enough? It can be expected that most states will amend their laws to establish some threshold for sales tax collection based on the volume of sales within the state.

The question of whether states will seek to apply their new standards retroactively will also arise. The Supreme Court found the fact that South Dakota's standard applied only on a prospective basis was a factor supporting its constitutionality under the Commerce Clause. While this does not guarantee that a state won't seek to impose a new standard retroactively, it should serve to encourage states to follow South Dakota's lead and make their new standards prospective.

While the decision allows tax collection to be mandated based on sales volume alone, alternate theories such as "click through" or "cookie" nexus will likely not go away, and the question of whether such rules are valid under the substantial nexus test will likely continue to be battled about for years.

What should taxpayers do?

Sellers that make out-of-state sales should examine their sales volume in anticipation of the new standards that will be adopted, as well as examine their other activities in those states where they have the greatest sales volume. Taxpayers may discover that they are currently conducting other activities that could expose them to prior period liabilities, and

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they may want to begin collecting tax now to minimize their exposure. Miller Canfield can assist companies in analyzing their current activities and developing a strategy for managing their sales tax liabilities in light of this important new development.