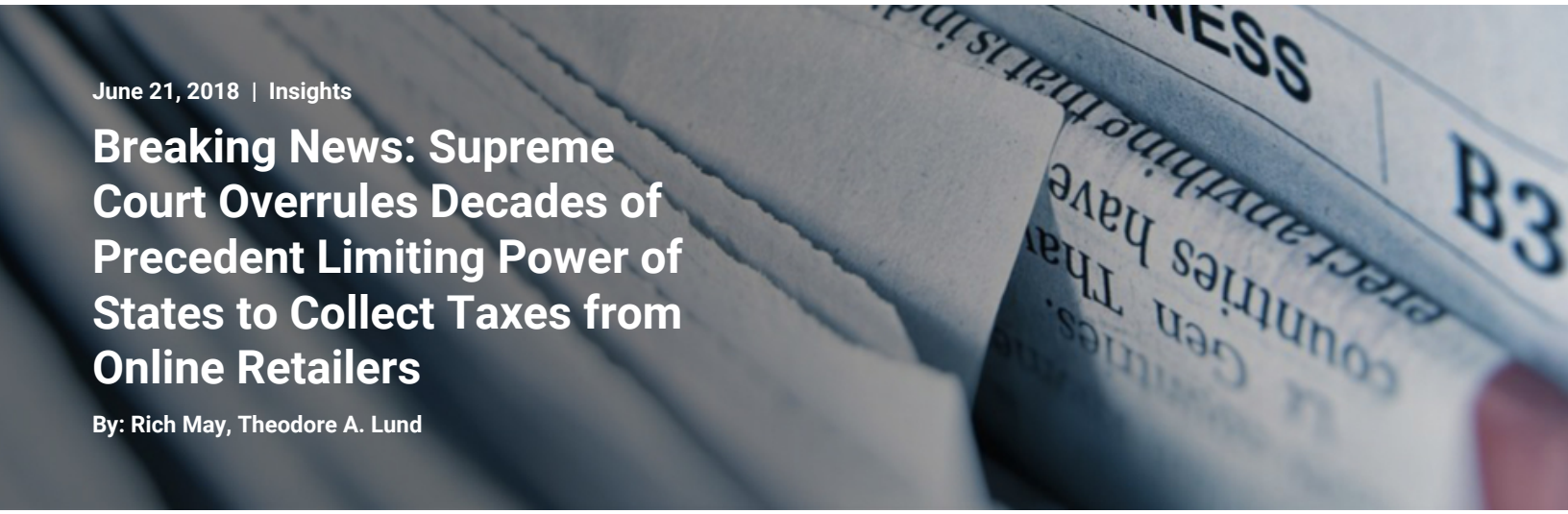


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Breaking News: Supreme Court Overrules Decades of Precedent Limiting Power of States to Collect Taxes from Online Retailers

By: Rich May, Theodore A. Lund

In a decision issued June 21, 2018 with national ramifications, the Supreme Court of the United States overruled over five decades of precedent limiting the power of states to collect sales and use taxes from out-of-state retailers shipping goods to consumers inside their state.



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See South Dakota v. Wayfair, Inc., et al., No. 17-494, 585 U.S. ___ (2018). This tax shelter for online retailers developed from the Supreme Court's holding in the 1992 case Quill Corp. v. North Dakota, 504 U. S. 298, which established that a mail-order catalog retailer lacked the required substantial nexus to the state to render collection and remission of tax constitutional. In the two decades since Quill, online retailers avoided state sales and use tax where they lack employees or real estate in a particular state – allowing them to offer lower prices.

With the meteoric growth in online retail sales, the Quill physical presence rule hurt state tax revenues and placed traditional brick-and-mortar retailers at a significant disadvantage. Though theoretically, individual consumers were still required to pay sales tax on goods they purchased from out-of-state retailers over the Internet, few consumers complied. Estimates of the loss in state tax revenues range from $8 billion to $33 billion nationwide, dollars which could be used to fund state infrastructure which Internet shippers do use and rely on – such as roads, police and fire departments, and banking institutions. Indeed, President Trump argued in recent months that large retailers need to pay their fair share of taxes compared to local retailers.

In response to the lost revenue, many states – including Massachusetts – passed laws to try to tax out-of-state Internet retailers selling goods to consumers in their states despite Quill. Today's decision arose from a challenge to the constitutionality of South Dakota's statute, which imposes the obligation only on large retailers who deliver more than $100,000 in goods to or engage in 200 or more transactions in the state. See S. 106, 2016 Leg. Assembly, 91st Sess. (S. D. 2016) (S. B. 106). In its decision, the Court overruled Quill to hold that those online retailers who exceed the thresholds have a substantial nexus with

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South Dakota. Because Quill's reasoning was largely based on and in response to a 1967 case, National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, it too was overruled by the Court today.

The Court's decision to overrule precedent – in this case long-standing precedent – is always notable. Today's 5-4 decision was extremely close. Justice Kennedy wrote the majority opinion joined by Justices Thomas, Ginsburg, Alito and Gorsuch. Here, the reason to overrule was not just the physical presence requirement's distortion of the marketplace between traditional brick-and-mortar stores, online retailers with a physical presence, and online retailers without one, but also based on principles of federalism. Without the Quill physical presence requirement, states can design their tax schemes with increasing flexibility given the rapidly changing nature of electronic commerce. Justices Thomas and Gorsuch filed separate concurring opinions, noting their thoughts on the precedential role of stare decisis and on separation of powers, respectively. Chief Justice Roberts, joined by Justices Breyer, Sotomayor, and Kagan, dissented. The dissent emphasized that Congress could have acted to overrule Quill itself under its plenary power over interstate commerce, with the judiciary's role under the dormant Commerce Clause limited to where Congress has not acted.

Today's decision will lead to some significant changes. Immediately, online retailers' stock prices have plummeted due to the likely permanent loss of this advantageous tax treatment. Looking towards the future, the decision will likely prompt new or revised state legislation nationwide. The Court explicitly referenced Massachusetts regulation 830 C.M.R. 64H.1.7, which requires internet vendors with a principal place of business outside the Commonwealth to register, collect, and remit Massachusetts sales or use tax if they complete 100 or more transactions in excess of $500,000 in sales in the 2018 calendar year. In addition to the differing threshold, the Massachusetts regulation differs from the South Dakota legislation ruled on today in another important respect. While South Dakota's legislature explicitly asked the Supreme Court to reconsider Quill in its Act, Massachusetts adapted the Quill physical presence standard to the Internet age. The Massachusetts regulation posits that Internet apps and website cookies create a substantial nexus between the retailer and the state just like a traditional warehouse did under Quill. The Massachusetts regulation was challenged by an online retailer in a currently pending case in Virginia. See Crutchfield Corp. v. Harding, Dkt. No. CL17001145-00 (Va. Cir. Ct., Albemarle County) (initial filing on Oct. 24, 2017, docket last updated on Mar. 2, 2018). The Supreme Court appears to agree with the Massachusetts interpretation in today's decision, likely rendering the pending challenge at least partially moot. States across the country will accordingly likely follow both the Massachusetts and South Dakota examples to broaden their own sales and use taxes.

With new state taxes coming, national retailers – even small individual listers on marketplaces like Etsy or eBay – may now need to comply with varying state and local tax regimes. Because there are up to 10,000 tax jurisdictions, software will likely rapidly develop in this arena to facilitate compliance. To address the concern of compliance across varying jurisdictions, it is possible that Congress will choose to act. Similarly, the states may choose to adopt a uniform national act.

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Despite such dramatic legal and business changes, consumers' wallets may not feel a significant impact. Consumers already pay sales tax at brick-and-mortar stores and to online retailers with a physical presence, like a warehouse for shipping, located in the state. Moreover, some large online retailers, including Amazon, already collect and remit tax on orders nationwide due to their extensive physical presence. Finally, the elimination of the Quill physical presence requirement does not mean that all state sales and use taxes are now constitutional. The Court emphasized that the Constitution continues to require a substantial nexus between the taxing state and the retailer, and statutes may continue to be challenged based on undue burden on or discrimination against interstate commerce. However, a major hurdle to state collection of revenue has been eliminated – a relic of mail-order retail in today's Internet age.

This summary is provided for educational and informational purposes only and is not legal advice. Any specific questions regarding the legal ramifications of this decision on your business should be directed to attorneys Theodore A. Lund or Jennifer Lang.

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