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High Court Kills Quill, But What's Left?

By Craig Fields, Mitchell Newmark and Eugene Gibilaro ·
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Craig Fields

Mitchell Newmark

Eugene Gibilaro

Chief Justice John Roberts quipped, "[w]hatever salience the adage 'third time's a charm' has in daily life, it is a poor guide to Supreme Court decisionmaking."[1] However, the third time was indeed a charm for the states and other opponents of the physical presence rule as the U.S. Supreme Court, in South Dakota v. Wayfair Inc., overruled its prior decisions in National Bellas Hess Inc. v. Department of Revenue[2] and Quill Corp. v. North Dakota[3] and held that physical presence in a taxing state is not necessary for the state to require an out-of-state seller to collect and remit the state's sales and use taxes.[4] While much attention will be paid to the outcome, the questions that the court has left for another day are just as important as businesses and practitioners begin to contemplate: "What happens now?"

Background

In 1967, the U.S. Supreme Court held in National Bellas Hess that a foreign mail-order business with no physical presence in Illinois could not be required to collect and remit Illinois use tax under the due process and commerce clauses of the U.S. Constitution.[5] Twenty-five years later in 1992, in Quill, the court reaffirmed the Bellas Hess physical presence rule for out-of-state sellers, albeit on the narrower basis of the commerce clause.[6]

In 2016, South Dakota enacted legislation that requires out-of-state sellers to collect and remit sales and use tax "as if the seller had a physical presence in the state" and provides a safe harbor if, on an annual basis, the seller: has $100,000 or less of sales of goods or services delivered into South Dakota, or engages in less than 200 separate transactions for delivery of goods or services into South Dakota.[7] The legislation also states that "[n]o obligation to collect and remit the sales tax required by this Act may be applied retroactively."[8]

The three companies challenging the South Dakota law were foreign, large, online retailers with no property or employees located in South Dakota (i.e., no physical presence in the state), but with amounts of sales and transactions delivered into South Dakota that exceed the safe harbor thresholds.

The Decision

In upholding the South Dakota law, the U.S. Supreme Court concluded that the physical presence rule "is unsound and incorrect" and that Bellas Hess and Quill "should be, and now are, overruled."[9] However, the court made clear that a state tax must still satisfy all four prongs of the test established in Complete Auto Transit Inc. v. Brady to pass constitutional muster under the commerce clause. A state tax must still:

Apply to an activity with a substantial nexus with the taxing state;

Be fairly apportioned;

Not discriminate against interstate commerce; and

Be fairly related to the services the state provides.[10]

In the absence of Bellas Hess and Quill, the court explained, the substantial nexus prong "is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."[11]

The court concluded that each of the companies here had a substantial nexus with South Dakota "based on both the economic and virtual contacts" with the state and the quantity of business done by the companies in South Dakota.[12]

Only the substantial nexus prong of the Complete Auto test was before the court in this appeal. Therefore, the court remanded the case to the South Dakota courts to determine "whether some other principle in the court's commerce clause doctrine might invalidate" the South Dakota law.[13] However, the court presaged the likely constitutionality of the South Dakota law because: the law provides a safe harbor to those who transact only limited business in South Dakota; the law expressly does not apply retroactively; and South Dakota has addressed uniformity with other states by adopting the Streamlined Sales and Use Tax Agreement.[14] These three prophylactic measures may set the bar for what will pass constitutional muster in the future.

What Happens Now?

An important unresolved issue in Wayfair is retroactivity. The court did not directly address the issue of whether states could retroactively impose a sales and use tax collection obligation on companies for prior years other than to note favorably the nonretroactivity of the South Dakota law when evaluating the law's constitutionality. It remains to be seen whether states can successfully apply Wayfair retroactively.

Another important issue is substantial nexus. The court did not directly address what the standard is, other than to say it is not physical presence and to look to the Complete Auto standard. The due process and commerce clauses are still alive to protect against overreach, albeit without a physical presence rule. The court previously eliminated bright-line formalistic rules for: due process nexus in International Shoe Co. v. Washington,[15] and subsequently set limits such as in J. McIntyre Machinery Ltd. v. Nicastro;[16] and state statutory language in Complete Auto and set limits in many subsequent cases. It has now eliminated the commerce clause bright-line nexus rule in Wayfair. However, if history is a

guide, new limits on commerce clause nexus will be set in subsequent cases.

Further, Wayfair only upholds the South Dakota law and only does so with respect to the issue of substantial nexus. It remains to be seen whether other state laws imposing collection obligations on out-of-state sellers will pass constitutional muster under Wayfair. To the extent other state laws apply retroactively, do not have sufficient safe harbor provisions or are otherwise burdensome on interstate commerce, those laws are ripe for constitutional challenges.

Finally, both the majority and dissent in Wayfair agreed that Congress has the authority to legislate a standard. Congress may create a different substantial nexus standard as long as that standard does not violate due process. It is unclear whether the Wayfair decision will make it more likely that Congress will take action to address the issue of non-uniformity in state taxation of interstate commerce. Stay tuned!

Craig B. Fields and Mitchell A. Newmark are both partners at Morrison & Foerster LLP.

Eugene J. Gibilaro is an associate at the firm.

[1] South Dakota v. Wayfair Inc., 585 U.S. ___, ___ (2018) (Roberts, J., dissenting) (slip op. at 3).

[2] 386 U.S. 753 (1967).

[3] 504 U.S. 298 (1992).

[4] 585 U.S. at ___ (slip op. at 22).

[5] 386 U.S. at 758.

[6] 504 U.S. at 317-318.

[7] S. 106, 2016 Legis. Assemb., 91st Sess. § 1 (S.D. 2016) ("S.B. 106").

[8] S.B. 106 Section 5.

[9] Wayfair, 585 U.S. at ___ (slip op. at 22).

[10] Complete Auto Transit Inc. v. Brady, 430 U.S. 274, 279 (1977).

[11] Wayfair, 585 U.S. at ___ (slip op. at 22) (alteration in original) (emphasis added) (quoting Polar Tankers Inc. v. City of Valdez, 557 U.S. 1, 11 (2009)).

[12] Id. at ___ (slip op. at 22-23).

[13] Id. at ___ (slip op. at 23).

[14] Id.

[15] 326 U.S. 310 (1945).

[16] 564 U.S. 873 (2011).