

Potential Implications of Supreme Court Revisiting *Quill's* Physical Presence Standard

Overview

On January 12, 2018, the U.S. Supreme Court ("Court") granted certiorari in *South Dakota v. Wayfair, Inc. et al.*,¹ a case challenging South Dakota's anti-*Quill* sales tax nexus law.² This significant development suggests that the U.S. Supreme Court may be ready to reconsider the decades-old physical presence nexus standard³ required in order for a state or locality to impose a sales or use tax collection responsibility upon a remote seller.

This challenge is not unexpected given comments by Justice Kennedy in the Court's 2015 decision in *Direct Marketing Association v. Brohl*.⁴ In a concurring opinion, Justice Kennedy stated:

There is a powerful case to be made that a retailer doing extensive business within a State has a sufficiently "substantial nexus" to justify imposing some minor tax-collection duty, even if that business is done through mail or the Internet. After all, "interstate commerce may be required to pay its fair share of state taxes." [Citation omitted.] This argument has grown stronger, and the cause more urgent, with time. When the Court decided *Quill*, mail-order sales in the United States totaled \$180 billion. [Citation omitted.] But, in 1992, the Internet was in its infancy. By 2008, e-commerce sales alone totaled \$3.16 trillion per year in the United States. [Citation omitted.]

Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier. [Citation omitted.] It should be left in place only if a powerful showing can be made that its rationale is still correct.⁵

This tax alert summarizes the common ways that states have expanded the notion of what is "physical presence" as well as the recent trend towards adoption of economic presence sales and use tax nexus thresholds. In addition, this alert will outline various compliance readiness considerations given a decision in *Wayfair* is anticipated sometime later this summer.

Recent state legislation – pushing the limits of "physical presence"

Even prior to the developments in *Wayfair*, states have enacted laws in the last decade that have expanded the notion of what is "physical presence" nexus for purposes of imposing a sales and use tax collection (or notice) responsibility on out-of-state sellers. These laws have generally fallen into one of the following categories.

Click-through nexus: A rebuttable presumption of nexus exists that an out-of-state seller has nexus in the state if the out-of-state seller enters into an agreement with an in-state online advertiser, in which the advertiser is compensated on a commission or a per click basis for referring potential customers to the out-of-state seller's website.

¹ *South Dakota v. Wayfair, Inc., et al.*, 901 N.W.2d 754 (S.D. 2017), cert. granted (U.S. Jan. 12, 2018) (No. 17-494).

² For additional details on the South Dakota law and the U.S. Supreme Court's grant of certiorari in *South Dakota v. Wayfair, Inc. et al.*, please see our previously issued MTS Alert available [here](#).

³ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁴ *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124, 1134-35 (2015) (Kennedy, J. concurring), available [here](#).

⁵ *Id.*

Affiliate nexus: A presumption of nexus exists if the out-of-state seller is a member of an affiliated group of corporations and any parent or subsidiary in the affiliated group has nexus with the state.

Notification and Information Reporting: If a remote seller does not have nexus and does not collect and remit the sales tax, certain states require the remote seller to notify both the customers and the respective state department of revenue that the customer may have a use tax obligation for the taxable purchases the customer made. Penalties for failure to comply with these notification requirements can be substantial.

Justice Kennedy's DMA comments spur direct Quill challenges

As noted above, Justice Kennedy remarks in the 2015 *DMA* decision directly challenged the ongoing relevance of a physical presence nexus requirement for sales and use tax nexus purposes. More than ten states have currently enacted sales and/or transaction-based economic nexus provisions imposing a sales and use tax collection duty on an out-of-state seller who makes retail sales of tangible personal property into the state if (1) the out-of-state seller's retail sales exceed a certain monetary threshold set by the state, or (2) the out-of-state seller reaches a certain number of transactions in one year as set by the state.⁶ The South Dakota law at the center of the *Wayfair* litigation is one such example.

Considerations

While outcome of *Wayfair* (as well as how states or Congress may respond if *Quill* is overturned) cannot be predicted, it is important that taxpayers review their compliance readiness given a decision is anticipated sometime later this summer. Such considerations include:

- Whether IT systems are in place to begin collecting if *Quill* is overturned.
- Whether existing IT systems are compatible with existing service providers or will new IT system implementations be required.
- Whether current financial statement positions have considered recent changes in state sales tax laws and regulations, such as click-through, affiliate, or economic nexus or notification requirements.
- In states with notification requirements, whether compliance with notification requirements, voluntarily registration, or another approach is appropriate considering current resources.
- How sales of products or services would be characterized in relevant states.
- Whether the required customer data is available to determine how to source sales if a sales and use tax obligation is imposed.
- Whether the increased compliance burden makes outsourcing sales and use tax compliance functions to a third-party a cost-effective alternative.

If the physical presence requirement of *Quill* is overturned, the sales and use tax nexus landscape will dramatically change. We anticipate that companies, large and small, may require significant changes to internal systems and processes. A delay in addressing the outcome of *Wayfair* may result in additional costs and/or delays considering expedited and compressed solution timelines. Companies are encouraged to consult with their indirect tax advisors to review the many technical and logistical considerations that should be addressed prior to the outcome of *Wayfair*.

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⁶ As of the date of this alert, those states include AL, IN, ME, MA, MS, ND, OH, PA, RI, SD, TN, VT, WA, and WY.

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