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Supreme Court Sides with State Law Requiring Tax Collection & Remittance by Out-of-State Merchants

Client Bulletins

The U.S. Supreme Court held in a 5-4 decision that states can require online retailers to collect sales tax, even when they do not maintain a physical presence in their borders. The opinion in *South Dakota v. Wayfair, Inc., et al.*, No. 17-494, overturns twenty-six year old jurisprudence barring just that.

The ruling is a major victory for the states which, by some estimates, have missed out on billions of dollars in tax revenue because of the Supreme Court's former Commerce Clause precedents.

The law at issue is a South Dakota bill requiring out-of-state retailers to collect and remit a 4.5% sales tax on all goods regardless of whether the seller has a brick-and-mortar presence or other significant contacts with the state—provided that the seller did at least $100,000 of business or conducted more than 200 transactions in South Dakota. In other words, sellers will have to collect and remit taxes wherever buyers reside, even if they have no other connection to or power in those states.

In his majority opinion, Justice Kennedy wrote that the physical presence rule set forth decades ago in *Quill v. North Dakota* had been outpaced by the nature of electronic commerce: "*Quill's* physical presence rule is artificial," the opinion said. "Modern e-commerce does not align analytically with a test that relies on the sort of physical presence defined in *Quill*."

Major sellers like Apple and Wal-Mart already collect and remit state sales tax for online purchases. Smaller sellers, however, were under no duty to collect sales tax unless they maintain a physical presence within the state in which the transaction occurs.

The Supreme Court's decision has the potential to reshape the marketplace for online goods as states will likely begin to follow South Dakota's lead in drafting legislation to tax online sales by foreign merchants. The "physical presence" loophole was a major factor in the early growth of e-commerce.

Now, the Court has cleared the way for all online sales to be taxed as if they took place in a retail store. The Court's majority opinion stressed the importance of a level playing field for businesses of all sizes. In his concurring opinion, Justice Neil Gorsuch wrote that online retailers had long reaped an unfair tax break "at the expense of in-state brick-and-mortar rivals."

The dissenters, Chief Justice John Roberts, Stephen Breyer, Sonia Sotomayor, and Elena Kagan expressed concern that the decision would mark a fundamental disturbance to a key element of the U.S. economy. "E-Commerce has grown into a significant and vibrant part of our national economy against the backdrop of established rules, including the physical presence rule," Roberts wrote. "Any alteration to those rules with the potential to disrupt the development of such a critical segment of the economy should be undertaken by Congress."

The markets responded to the decision with some pessimism. The Wall Street Journal reported that Amazon, Overstock.com, Wayfair, Etsy, Ebay, and New Egg saw their stock prices fall in the wake of the decision's release.

Online retailers should brace for further market flux as the reverberations of yesterday's opinion could alter the shopping habits of American consumers.

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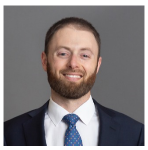

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