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SHOP TALK

South Dakota v. Wayfair: A Look at the Cert Petition

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At the time of this writing, the state tax community is abuzz with speculation about whether the U.S. Supreme Court will decide to hear *South Dakota v. Wayfair,*[1] the case addressing the constitutionality of South Dakota's sales tax economic nexus statute and the continuing vitality of *Quill*'s physical presence rule. The petition for a writ of certiorari and amicus briefs in support of the petition have now been filed.[2] They criticize *Quill* and physical presence from a variety of different angles.

This article summarizes the main arguments from the petition and from the amicus briefs.[3] It then enumerates potential actions the Court could take in response to the petition. It concludes that sales/use tax nexus complexity will likely continue to persist regardless of what the Court decides to do (or not do) in response to the *South Dakota v. Wayfair* cert petition.

The petition for a writ of certiorari

A case will be placed on the Supreme Court's docket only if the "Rule of Four" is satisfied and four justices decide to review the case.

The *South Dakota v. Wayfair* cert petition seems particularly focused on Justices Kennedy, Gorsuch and Thomas, sprinkling quotes from them at the beginning of the petition. The logic is evidently that if those three justices are interested in the case (and particularly in abrogating *Quill*) then it will only be necessary to garner the interest of one additional justice for the cert petition to be granted.

The cert petition leads with quotes from Justice Kennedy's *DMA Marketing* concurrence.[4] It also places upfront a Tenth Amendment argument seemingly aimed at Justices Gorsuch and Thomas, to wit that

Quill's physical presence rule is atextual (it cannot be derived from constitutional text) and thus presents a separation of powers problem by "seiz[ing] a power from the States" since the states would be permitted to craft their own nexus rules absent the judicially crafted physical presence rule.

In support of the South Dakota nexus thresholds (200 total annual sales or $100,000 total annual in-state sales), the petition states that the thresholds ensure that only businesses with substantial in-state activity will be caught in the net. The South Dakota nexus test "guarantees that the retailer's relationship to the State is 'substantial' . . . based on a legally and economically meaningful measure."[5]

The cert petition conversely characterizes the physical presence nexus standard as not only outdated but also unworkable, because it leads to considerations of whether the physical presence of affiliates, employees, or company websites on smart phones creates physical presence for the vendor, leading to "high-stakes litigation as states increasingly expand their definitions of physical presence-a development that entirely post-dates *Quill.*"[6]

As described in the cert petition, physical presence nexus leads to determinations hinging on somewhat arbitrary factors (such as the occasional in-state presence of a salesperson) that are not necessarily fair gauges of whether a vendor's presence in the state is substantial: "the *Quill* rule turns the 'physical presence' requirement into a dangerous trap. If a sales representative from an internet retailer in Oklahoma goes to a conference in Texas and ends up making a sale there over lunch, his company is now arguably liable for millions in sales taxes it never collected from Texas purchasers-a result far worse than just collecting and remitting itself."[7]

The petition addresses factors that the Court has previously considered in deciding whether to overrule a prior decision, specifically whether the decision: (1) was decided on constitutional or statutory grounds; (2) has engendered legitimate reliance interests; (3) has been undermined by changed circumstances; (4) has been consistently criticized, and is now seen as sufficiently inconsistent with other doctrine that it is a detriment to coherence in the law; and (5) has proven "unworkable" and/or outdated.[8] Applying each of these factors, the cert petition argues that *stare decisis* no longer justifies retaining the physical presence standard.

The cert petition uses forceful language throughout and characterizes physical presence nexus as akin to a rule of law that is hanging by a thread, one that should be cut.

Amicus briefs in support of the petition

Over a dozen amici submitted briefs in support of the cert petition, including the National Governors Association, the Streamlined Sales Tax Governing Board, the Multistate Tax Commission, and a variety of industry trade groups. Below are summaries of key points from several of the amicus briefs.

National Governors Association: This amicus brief, from a bipartisan association of state governors, argues that *Quill* is hampering efforts to collect sales/use taxes that "are already owed."[9] Realistically, many individuals do not pay use tax. So by preventing states from forcing out-of-state retailers to collect tax, *Quill* is causing considerable revenue to escape state coffers. While conceding that nexus laws such as click-through nexus are effectively a workaround, this amicus brief states that these laws are not generating the anticipated sales tax revenues and that an economic nexus law like South Dakota's is the only way to allow states to "capture . . . the rightful share of current taxes due States by online retailers who generate large revenues through their business activity in a particular State."[10] Overall, the message is one of requesting that the Court remove an obstacle that is hindering the states' ability to obtain revenue rightly theirs.

Multistate Tax Commission: The Multistate Tax Commission's amicus brief frames physical presence as outdated in light of modern filing technologies. It states that the physical presence rule is difficult to apply in practice, leading to haphazard litigation and concluding that physical presence does not "produce reliably consistent or predictable results, necessary for both states and taxpayers to have certainty."[11]

Streamlined Sales Tax Governing Board: The Streamlined Sales Tax Governing Board's amicus brief argues that the Streamlined project has obviated the need for *Quill*'s physical presence rule. A key rationale in *Quill* was that multistate use tax compliance was too complicated, with different exemptions, different tests, multiple tax returns to file, etc. This rationale has been undercut, according to the Board's brief, by many states' conformity to the Streamlined Sales and Use Tax Agreement, which includes standardized rates, exemptions, definitions, and administrative requirements.

Tax Foundation: The Tax Foundation has historically filed amicus briefs supporting physical presence. However, in this amicus brief it argues that there is so much variation between how states interpret and apply physical presence and impose reporting requirements, that the Court should re-address use tax nexus. It further argues that South Dakota's statute is a perfect vehicle for addressing this important issue and that the South Dakota statute should be ruled constitutional, in part because it has a *de minimis* threshold and a provision barring retroactive collection.

Law professors and economists in support of petitioner: This amicus brief, signed by roughly 30 tax professors, argues first that *Quill*'s rationale is grounded in economic considerations (for example, the costs to small vendors of complying with sales/use tax obligations imposed by 6,000 jurisdictions). Then, it argues that these conditions have changed and that an economic analysis now supports overruling *Quill.* The economic points made are that: (1) revenue losses for the states are increasing since *Quill* was decided because more sales are being consummated online; (2) *Quill* distorts consumption choices by encouraging people to buy goods online, rather than in stores, leading to economic inefficiency; and (3) the physical presence rule discourages vendors from expanding across state lines, leading to inefficient production and distribution choices. It also argues that compliance burdens are better shouldered by vendors than consumers.

American Booksellers Association: The next few amicus briefs that will be summarized are from trade or industry groups. They address *Quill*'s impact on specific industries. The booksellers' brief describes *Quill* as an "existential threat" to independent bookstores. In making this point, they focus on a few characteristics unique to books. First, books can easily be shipped and are lightweight, so usually qualify for free shipping. Second, books are non-unique, so if a purchaser has a title in mind there is a clear advantage to saving money (the sales tax) by buying the book online. This amicus brief also describes the difficulties particular independent bookstores have had staying afloat in light of the challenges *Quill* poses to their industry.

Retail Litigation Center: The Retail Litigation Center's amicus brief states that retailing has changed significantly since *Quill* was decided, and conditions are difficult for brick-and-mortar retailers. It underscores that retailers put themselves at a competitive disadvantage compared to online retailers if they expand operations into new states. A retailer that expands operations throughout the United States must collect sales or use tax in all states that impose sales/use tax, whereas its competitors that sell chiefly online will not have to collect use tax in many states. "Retailers now hesitate to expand into new states precisely to avoid such a disadvantage."[12] Echoing arguments made in some of the other briefs, this brief also makes the point that *Quill* is not always easy to apply and some states have pushed its limits, leading to uncertainty and litigation.

American Lighting Association: "Showrooming," the practice of visiting a store in order to examine a good before buying it online, is a key concept discussed in this amicus brief. It argues that "showrooming" was not a problem for retailers in 1992, as it is today, because in 1992 it was not possible to take a smart phone into a mall and comparison shop online for items viewed in the mall. It argues that *Quill* contributes to, or exacerbates, showrooming because shoppers can save money by finding a seller online that does not collect use tax for sales made into the state and can then make the purchase from that retailer, rather than making an in-store purchase.

American Farm Bureau Federation: This amicus brief argues that *Quill* harms rural businesses such as farms. The logic is that *Quill* drives more business online, thereby draining sales tax revenue from local communities, leading to increased property taxes to make up for the lost revenue, which hurts land-based businesses that suffer greatly when property taxes are high. "This diversion of business to online retailers forces local governments in some cases to try to make up for lost revenue by increasing property taxes-a burden that falls heavily on land-based business owners like farmers and ranchers."[13]

National Retail Federation: Members of the National Retail Federation ("NRF") are in a bind about whether to collect sales/use taxes. "The risk of retailers misapplying the law and facing significant financial consequences is real, particularly with recent legislative action in the states. Some NRF members, therefore, are choosing to voluntarily collect state taxes, even though they do not believe they are technically required to do so under *Quill.* Others still are taking the risk of not collecting state sales taxes for the majority of their online transactions and, for the moment, have a commensurate pricing advantage over remote sellers who are asking customers to pay the tax . . . . In both cases, the need for certainty and a test that comports with the complexities of modern commerce is paramount."[14]

Options for the Court

Together, the cert petition and amicus briefs provide legal, conceptual, economic, and practical reasons for overturning *Quill.* The U.S. Supreme Court must decide what to do and it has several options.

First, the Court could decide not to touch this issue. The Court in *Quill* wrote that: "the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve . . . ."[15] So the Court could decline to grant certiorari and leave *Quill* standing, reasoning that Congress is better situated to set a nationwide sales/use tax jurisdictional standard.

Second, the Court could grant oral argument and re-affirm *Quill* for the exact same reasons it provided for ruling in Quill's favor in 1992.

Either of these options would leave sales/use tax nexus the same as it is now (muddied, confusing, and uncertain, as recounted in the cert petition and the amicus briefs in support). States would likely respond by continuing to expand the boundaries of what "physical presence" means and many states would likely look at adopting reporting requirements similar to those in place in Colorado.

Alternatively, the Court could grant oral argument, overturn *Quill*, and declare the South Dakota statute constitutional. If this happens, it is likely that all or nearly all of the 45 states that impose a sales/use tax would respond by adopting nexus statutes similar to the South Dakota statute (if they have not done so already).

It would then be clear that large online sellers need to collect use tax for in-state sales, but nexus complexity would not be eliminated altogether. Many states would likely retain their click-through nexus statutes, agency nexus statutes, and affiliate nexus statutes. So a business that does not meet the economic nexus threshold (say $100,000 in sales or 200 total sales annually) in a state would still need to check to see if it meets the state's click-through nexus threshold ($5,000 in many states), or if it is sending employees or independent contractors into the state to develop a market in the state, or even whether it should be collecting use tax in the state due to cookie nexus.

In other words, if the Court declares economic nexus constitutional it seems most likely that this would provide a new basis to support requiring vendors to collect use tax in a state without necessarily eliminating the old bases. For compliance purposes, it would then be necessary for vendors to check first to see if they trip a state's economic nexus statute and, if not, then to check to see if they cross some other nexus red line (be it statutory, regulatory or administrative) in the state.

If the Court rules the South Dakota statute constitutional there could still be as-applied challenges. For example, consider an out-of-state antiques dealer that ships a single antique that costs more than $100,000 to an in-state buyer or an out-of-state online school supply store that ships 500 boxes of wood pencils costing $1.99 to 200 different addresses in the state. Would these sellers have an argument that the statute is unconstitutional as applied to them and that their connections to the state are not "substantial," such that they cannot be forced to collect use tax, even if the statute has been ruled constitutional as a general matter? These examples might seem far-fetched, but surely at least some fact patterns like this would emerge if economic nexus for sales tax is ruled constitutional.

Should the Court decide to hear the case and reverse *Quill*, the language the Court deploys would be of paramount importance. A broadly worded decision made on Tenth Amendment grounds criticizing the dormant Commerce Clause standard could call into question taxpayer protections contained in *Complete*

Auto[16] and its progeny. While the cert petition is careful to say that it is not necessary for the Court to abandon the dormant Commerce Clause to rule in South Dakota's favor, the cert petition quotes approvingly language from Justice Thomas' dissent in *Camps Newfound* that the dormant Commerce Clause "makes little sense, and has proved virtually unworkable in application."[17] Companies that are generally indifferent to sales/use tax nexus issues have something to lose if the Court decides to use *South Dakota v.Wayfair* as a vehicle to re-examine the entire dormant Commerce Clause, not just the physical presence sales/use tax nexus standard.

It is anyone's guess what (if anything) the Court will decide to do in response to the *South Dakota v.Wayfair* cert petition or to further shape the sales/use tax nexus area. However, regardless of what the Court decides to do (or not do) it seems likely that nexus complexity will persist.

[1] The South Dakota Supreme Court's decision is *State of South Dakota v. Wayfair, Inc.,* 901 N.W.2d 754 (S.D. 2017).

[2] The brief in opposition had not been filed at the time of this writing (November 2017).

[3] Due to space constraints, not every amicus brief is summarized.

[4] *See Direct Marketing Ass'n v. Brohl*, 135 S. Ct. 1124 (2015) (Kennedy, concurring). One such quote is the following: "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."

[5] South Dakota's Petition for Writ of Certiorari, pp. 34-35.

[6] *Id.* at 34.

[7] *Id.* at 18.

[8] *Id.* at 27.

[9] National Governors Association Amicus Brief, p. 16.

[10] *Id.* at 8.

[11] Multistate Tax Commission Amicus Brief, p. 15.

[12] Retail Litigation Center Amicus Brief, p. 17.

[13] American Farm Bureau Federation Amicus Brief, p. 4.

[14] National Retail Federation Amicus Brief, p. 16.

[15] *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992).

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

[17] *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 610 (1997) (Thomas, J. dissenting).