

Supreme Court Puts on Its Summer Flip Flops

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On June 21, 2018, the United States Supreme Court, in *South Dakota v. Wayfair, Inc.*, held that a state can now require companies not physically present in that state to collect tax on internet sales made to its residents.

The explosive growth of e-commerce combined with the states' eroding tax base convinced the Supreme Court to turn back a half century of jurisprudence. Faced with losses estimated between \$8 billion and \$33 billion every year, the Court affirmed the states' right to adapt their taxing authority to accommodate a rapidly expanding internet economy. This ruling effectively gives state legislatures the green-light to collect sales tax from online transactions.

Contrary to popular belief, the states have always had the ability to tax online sales made to their residents. The states' problem, however, has been with enforcement because the states could only collect the sales tax directly from their residents. The overwhelming majority of consumers fail to voluntarily self-report these online purchases and pay use tax (the equivalent of sales tax) on these purchases. Until yesterday, states were barred from requiring companies to collect and remit those taxes on behalf of consumers unless they had some sort of physical presence within the state (for example, one or more stores, employees, etc.).

Justice Kennedy, writing for the majority of the Court, emphasized the disparate impact this physical presence requirement had on local brick-and-mortar stores in a rapidly growing digital economy:

For example, a business with one salesperson in each State must collect sales taxes in every jurisdiction in which goods are delivered; but a business with 500 salespersons in one central location and a website accessible in every State need not collect sales taxes on otherwise identical nationwide sales. In other words, . . . a small company with diverse physical presence might be equally or more burdened by compliance costs than a large remote seller.

Contrary to the Commerce Clause's purpose in leveling the playing field of interstate commerce, the Court reflected on how its previous opinions served to put local businesses at a disadvantage. Taking responsibility for these artificial market distortions, the Court signaled its departure from long standing precedent, concluding that the physical presence requirement is both "unsound and incorrect." The Court noted that in eliminating the physical presence requirement—and without creating a bright-line rule—this decision opens the door for further litigation to determine the outer edges of its application.

The Court's ruling however is somewhat limited in scope and does not apply to out-of-state businesses with minimal in-state sales. The decision approved of a South Dakota law that applies to out-of-state merchants who either have more than 200 separate transactions in South Dakota or sell more than \$100,000 worth of goods into South Dakota annually.

The obvious outcome from this decision will be a move by states to begin implementing taxing schemes that are similar, or possibly more aggressive, to those contained in South Dakota's law as

soon as possible. Many states already possess the administrative framework necessary for such implementation, requiring only the legislative mandate to do so. Companies therefore should brace for a wave of new legislation requiring the assessment, collection, and remittance of sales tax in every state where they currently do substantial business, online or otherwise.

Christopher Neal, 2018 Summer Associate, contributed to this alert.