

The Obligation To Collect And Remit Sales Tax To Other States: The Impact of South Dakota v. Wayfair, Inc.



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One of the most interesting, recent cases before the U.S. Supreme Court is one in which the Court was faced with deciding the extent of a state's ability to collect tax from sales made to consumers within the state, by an out-of-state merchant, under the Commerce Clause. *South Dakota v. Wayfair, Inc.*, 201 L.Ed.2d 403, 138 S. Ct. 2080 (2018). The *Wayfair* decision is an important one—not only because it reflects a recognition by our highest Court about our nation's ever-expanding interstate economy—but also because it overturned more than 25 years of Supreme Court precedent and “the physical presence rule” outlined in *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992). In light of the significance of the *Wayfair* decision and its impact on local business, Minnesota lawyers should be aware of it.

Many states, including South Dakota, impose sales tax on consumers' purchases of goods and services within the state. *Id.* at 2087. The *Wayfair* decision was an appeal from the dismissal of a declaratory judgment action brought by the State of South Dakota against merchants Wayfair, Inc., Overstock.com, Inc. and Newegg, Inc. (“Respondents”), from whom South Dakota sought to collect sales tax. 138 S.Ct. at 2089. South Dakota's case against Respondents was based on its recently-enacted state statute requiring merchants selling online goods and services to consumers within South Dakota to collect and remit sales tax to the state. *Id.* at 2088. The statute was enacted because the South Dakota legislature “found that the inability to collect

sales tax from remote sellers was ‘seriously eroding the sales tax base’ and ‘causing revenue losses and imminent harm . . . through the loss of critical funding for state and local services.” *Id.* (citing S. 106, 2016 Leg. Assembly, 91st Sess. § 8(1) (S.D. 2016)).

The trial court dismissed South Dakota's declaratory judgment case summarily, finding the statute unconstitutional under *Quill*. South Dakota's Supreme Court reluctantly affirmed the dismissal, stating, “[h]owever persuasive the State's arguments on the merits of revisiting the issue, *Quill* has not been overruled and remains the controlling precedent on the issue of Commerce Clause limitations on interstate collection of sales and use taxes.” 138 S.Ct. at 2089 (citing 901 N.W.2d at 761). Thus, the *Wayfair* Court decided to revisit *Quill* and answer the question of whether out-of-state merchants (i.e., Respondents) could be required to collect sales tax on sales they make to consumers in South Dakota and remit those taxes to the state. *Id.* at 2087. Although Respondents did not have any employees or real estate in South Dakota and therefore no “physical presence” in the state as required in order to be able to collect tax under *Quill*, the Court was troubled by the fact that Respondents sold millions of dollars of goods and services within South Dakota without collecting or remitting any sales tax. 138 S.Ct. at 2089.

A significant portion of the *Wayfair* Court's opinion analyzed the reasons why the Court should finally do away with “physical presence rule,” noting that the rule has “been the target of criticism over many years from many quarters.” *Wayfair*, 138 S.Ct. at 2092. The Court explained that “[e]ach year, the physical presence rule becomes further removed from economic reality and results in significant revenue losses to the States,” and that critiques of the rule “underscore that the physical presence rule, both as first formulated and as applied today, is an incorrect interpretation of the Commerce Clause.” *Id.* Supporters of the physical presence rule argue that it “has permitted start-ups and small businesses to use the Internet as a means to grow their companies and access a national market, without exposing them to the daunting complexity and business-development obstacles of nationwide sales tax collection.” *Id.* at 2098 (citing Respondents' Br.). In a well-reasoned and thorough analysis, the Court vacated the South Dakota Supreme Court's decision, which held that South Dakota's statute violated the Commerce Clause by requiring internet sellers with no physical presence in the state to collect and remit sales tax. 138 S.Ct. at 2100. In doing so, the Court overruled *Quill*, making clear the Court's intent to do away with the “physical presence rule.” *Id.* at 2092-2098.

One of the most interesting aspects of the *Wayfair*

case—especially considering how our highest Court is changing—was the split amongst the justices. Justice Kennedy delivered the opinion of the Court, in which Justices Thomas, Ginsburg, Alito and Gorsuch joined (although Justices Thomas and Gorsuch filed concurring opinions). Justice Roberts filed a dissenting opinion in which Justices Breyer, Sotomayor and Kagan joined. According to the dissent, the problem with the majority's opinion in *Wayfair* is that it creates significant and unnecessary burdens on small businesses. Referring to the majority opinion, the dissent stated:

The Court . . . breezily disregards the costs that its decision will impose on retailers. Correctly calculating and remitting sales taxes on all e-commerce sales will likely prove baffling for many retailers. Over 10,000 jurisdictions levy sales taxes, each with “different tax rates, different rules governing tax-exempt goods and services, different product category definitions, and different standards for determining whether an out-of-state seller has a substantial presence” in the jurisdiction. *Id.* at 2103 (J. Roberts, dissent.) Anticipating this argument, the majority noted:

Eventually, software that is available at a reasonable cost may make it easier for small businesses to cope with these problems. Indeed, as the physical presence rule no longer controls, those systems may well become available in a short period of time, either from private providers or from state taxing agencies themselves. And in all events, Congress may legislate to address these problems if it deems necessary and fit to do so.

Id. at 2098.

It remains to be seen how the states will respond to the Court's *Wayfair* decision. According to the Minnesota Department of Revenue, as a result of *Wayfair*, “[r]emote sellers that sell goods or services into Minnesota from other states must register and begin collecting sales tax in Minnesota no later than October 1, 2018.” <http://www.revenue.state.mn.us/businesses/sut/Pages/Remote-Sellers.aspx> (last visited, October 15, 2018). Also, “Minnesota businesses that remotely sell into other states may also need to start collecting sales tax in those states.” *Id.*

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