

## COMMENT

### THE ERADICATION OF ONLINE RETAILERS' TAX SHELTER: HOW *SOUTH DAKOTA V. WAYFAIR* ELIMINATED THE PHYSICAL PRESENCE STANDARD AND REINTERPRETED THE COMMERCE CLAUSE TO ALLOW COLLECTION OF STATE SALES TAX ON REMOTE SELLERS

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#### ABSTRACT

This Comment argues how the Court's decision in *South Dakota v. Wayfair* correctly clarified the area of law surrounding state sales tax collection for remote sellers engaged in interstate commerce. Section A summarizes how the Commerce Clause has previously been interpreted and how *Wayfair* overrules the physical presence standard precedent in favor of correct constitutional interpretation. Section B begins by discussing why precedent in this area of law was unpractical and needed to be overruled, even in the face of stare decisis. Sections C and D then further explain the new economic and virtual contacts test established and the problems that this *Wayfair* test will solve. This Comment also acknowledges that subsequent action by businesses, states, and Congress is bound to happen, leaving questions unanswered. Lastly, it discusses why the dissent's reasoning is unsound with the current growth and prevalence of e-commerce.

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## I. INTRODUCTION

In *South Dakota v. Wayfair*, the Supreme Court of the United States eliminated the physical presence standard; which required a business to have a physical presence in the state before the state could compel the business to collect a sales tax from customers.<sup>1</sup> In *Wayfair*, the state of South Dakota sought to collect sales tax from Wayfair, Inc., Overstock.com, and Newegg, Inc., three major online retailers who did not satisfy the requirements of the physical presence standard.<sup>2</sup> After denying certiorari for similar cases, it seemed unlikely that the Court would review *Wayfair*, but for the first time in more than twenty-five years, the Supreme Court unexpectedly granted certiorari for a sales tax collection case.<sup>3</sup> *Wayfair* is considered by many to be the “tax case of the millennium”.<sup>4</sup>

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1. *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2087–88, 2099 (2018).

2. *Id.* at 2089.

3. Gerald J. Donnini II, *Reasonable Answer Done the Wrong Way: Supreme Court Overturns Quill in South Dakota v. Wayfair, Inc.*, 92 FLA. B.J. 82 (2018).

4. Joe Stanley-Smith, *US Supreme Court Decision in Wayfair Sales Tax Case Imminent*, INT’L TAX REV. (June 13, 2018), <http://www.internationaltaxreview.com/Article/3813712/US-Supreme-Court-decision-in-Wayfair-sales-tax-case-imminent.html> (quoting the unofficial name created by the National Conference of State Legislatures).

In 2016, the South Dakota legislature feared losing millions of tax dollars and declared an emergency, which led them to subsequently pass an Act to provide for the collection of taxes from certain remote sellers.<sup>5</sup> Since South Dakota declared an emergency, the law was fast tracked by “authorizing a state declaratory judgment action with limited discovery and direct appeal to the South Dakota Supreme Court.”<sup>6</sup> The Act called for amendment by state statute to require businesses that deliver more than \$100,000 of goods or services into the state, or engage in two-hundred or more separate transactions, to collect and remit sales tax.<sup>7</sup> All respondents satisfied these two thresholds, but refused to collect sales tax from their customers.<sup>8</sup>

The inability to require a business to collect sales tax caused South Dakota losses between \$48 and \$58 million annually, and all states collectively losses between \$8 and \$33 billion annually.<sup>9</sup> The Court considers the physical presence rule, and by extension, its losses, to be “an extraordinary imposition by the Judiciary on States’ authority to collect taxes and perform critical public functions.”<sup>10</sup> Forty-one other states supported the alteration or elimination of the physical presence standard.<sup>11</sup> Thirty-one states already imposed tax on internet sales, and the *Wayfair* decision will only change how these states now reevaluate these laws.<sup>12</sup>

South Dakota challenged the physical presence standard, which the Court replaced with an economic and virtual nexus test, thereby overruling the previous decision of *Quill Corp. v. North Dakota*.<sup>13</sup> Through this ruling, the Court held that a seller is not required, under the Commerce Clause, to have a physical presence in a state, but economic and virtual contacts create a sufficient

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5. 2016 S.D. Sess. Laws ch. 70, § 8.

6. Matthew C. Boch, *Way(un)fair?: United States Supreme Court Decision Ends State Tax Physical Presence Nexus Test*, 53 ARK. LAW. 18, 19 (2018).

7. 2016 S.D. Sess. Laws ch. 70, § 1.

8. Michael Knoll, *The Implications of the Supreme Court’s Wayfair Decision*, REG. REV. (July 24, 2018), <https://www.theregreview.org/2018/07/24/knoll-implications-supreme-courts-wayfair-decision/>.

9. *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2088 (2018).

10. *Id.* at 2095.

11. Mark Walsh, *Argument Preview: Justices to Reconsider Sales-Tax Collection in Internet Era*, SCOTUSBLOG (April 10, 2018, 10:46 AM), <http://www.scotusblog.com/2018/04/argument-preview-justices-to-reconsider-sales-tax-collection-in-internet-era/>.

12. Joseph Bishop-Henchman, *Supreme Court Decides Wayfair Online Sales Tax Case*, TAX FOUND. (June 21, 2018), <https://taxfoundation.org/supreme-court-decides-wayfair-online-sales-tax-case/>.

13. Michael Giovannini & Matt Hedstrom, *Thanks for the Memories*, ALSTON & BIRD 1 (June 22, 2018), <https://www.alston.com/-/media/files/insights/publications/2018/06/1834-34-wayfair.pdf>.

substantial nexus to allow sales tax collection.<sup>14</sup> *Wayfair* is a significant case because it reconsiders the scope and validity of the physical presence rule that has been mandated by earlier cases, while reconstructing the interpretation of the Commerce Clause.<sup>15</sup>

A closely divided and split Supreme Court decided the *Wayfair* decision.<sup>16</sup> In earlier decisions, Justices Kennedy, Thomas, and Gorsuch all “indicated that they may be ready to re-examine the *Quill* decision.”<sup>17</sup> The dissenting justices felt Congress should make the decision and that prior inaction indicated that Congress was satisfied with the current system.<sup>18</sup> However, the Court was urged by bipartisan support to reconsider *Quill*.<sup>19</sup>

## II. BACKGROUND

The Court interpreted the Commerce Clause on several occasions throughout history and has “indicated that the power to regulate commerce in some circumstances was held by the States and Congress concurrently.”<sup>20</sup> However, a state’s authority may not discriminate against interstate commerce, and states may not impose undue burdens on interstate commerce.<sup>21</sup>

“For more than 50 years, [the test] of whether a state could impose tax requirements looked to whether the taxpayer had a physical presence in the state.”<sup>22</sup> In 1967, *Bellas Hess* held that both the Due Process Clause and the Commerce Clause required a business to have “minimum contacts with a state” and that a business whose contacts were limited to mail and common carrier

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14. *Id.*

15. *See generally Wayfair*, 138 S. Ct. 2080.

16. *See* Adam Liptak, *Supreme Court Divided on Sales Taxes for Online Purchases*, N.Y. TIMES (April 17, 2018), <https://www.nytimes.com/2018/04/17/business/justices-divided-on-sales-taxes-for-online-purchases.html?action=click&module=RelatedCoverage&pgtype=Article&region=Footer>.

17. Adam Liptak, *Justices to Hear Cases on Voting Rights and Internet Taxes*, N.Y. TIMES (Jan. 12, 2018), <https://www.nytimes.com/2018/01/12/us/politics/justices-voting-rights-internet-taxes.html?action=click&module=RelatedCoverage&pgtype=Article&region=Footer>.

18. *Wayfair*, 138 S. Ct. at 2101-05 (Roberts, C.J., dissenting, joined by Justices Breyer, Sotomayor, and Kagan).

19. Adam Liptak, Ben Casselman & Julie Creswell, *Supreme Court Widens Reach of Sales Tax for Online Retailers*, N.Y. TIMES (June 21, 2018), <https://www.nytimes.com/2018/06/21/us/politics/supreme-court-sales-taxes-internet-merchants.html>; *see* Bishop-Henchman, *supra* note 12.

20. *Wayfair*, 138 S. Ct. at 2090.

21. *Id.* at 2091.

22. Boch, *supra* note 6, at 18.

deliveries were insufficient.<sup>23</sup> Under *Bellas Hess*, states were prohibited from taxing remote sellers who did not have a physical presence in the state, but at the time of this decision, mainly catalogues and phone orders were used.<sup>24</sup> The physical presence standard was later reexamined in 1992 when *Quill* overruled the Due Process Clause holding of the *Bellas Hess* case, but reaffirmed the physical presence standard under the Commerce Clause.<sup>25</sup> *Quill* found that physical presence was not necessary for Due Process concerns and that this was settled law.<sup>26</sup> The “separation of the Due Process Clause and the Commerce Clause into distinct constitutional limitations” is important because it was the first time the Court recognized two different concerns of state taxation on remote sellers.<sup>27</sup>

Whereas Due Process is concerned with equitability and the minimum link between the state and the transaction, the Commerce Clause is meant to prevent discrimination and undue encumbrances on interstate commerce.<sup>28</sup> *Wayfair* reaffirms this by acknowledging the significant parallels between the two, but not considering them as being identical in the analysis.<sup>29</sup> Through *Quill* and *Bella Hess*, the Court developed a “bright-line rule requiring [there be] physical presence, due to the commerce clause,” before a state may collect taxes from retailers.<sup>30</sup>

*Quill* has been applied for the past twenty-six years and has required that activities in a state be substantial enough to justify a state’s exercise of jurisdiction of power.<sup>31</sup> *Quill* prohibited the states “from imposing a sales tax on out-of-state retailers that do not have a physical presence in the state, such as a store, warehouse or sales representative.”<sup>32</sup> Although the Court made an “explicit plea for Congress to resolve the physical presence dilemma through legislation,” the decision in *Quill* put commerce into further troubled water.<sup>33</sup>

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23. *Wayfair*, 138 S. Ct. at 2085 (citing to *Nat’l Bellas Hess, Inc. v. Dep’t of Revenue of State of Ill.*, 386 U.S. 753, 758 (1967)).

24. Knoll, *supra* note 8; Stanley-Smith, *supra* note 4.

25. *Wayfair*, 138 S. Ct. at 2091–92 (citing to *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)).

26. Timothy M. Todd, *Supreme Court’s Quill and Wayfair Cases Explained*, FORBES (June 27, 2018, 2:26 PM), <https://www.forbes.com/sites/timtodd/2018/06/27/supreme-courts-quill-and-wayfair-cases-explained/#74b91c2972a4>.

27. Giovannini & Hedstrom, *supra* note 13, at 3.

28. *Id.*

29. *Id.*

30. Todd, *supra* note 26.

31. *Id.*

32. Walsh, *supra* note 11.

33. Donnini II, *supra* note 3, at 82.

Between the years of *Bellas Hess* and *Quill*, *Complete Auto* was decided in which the Court created a four part test for state taxation.<sup>34</sup> This framework established that the tax must “appl[y] to an activity with a substantial nexus with the taxing state,” be fairly apportioned, must not “discriminate against interstate commerce,” and be “fairly related to the services the state provides.”<sup>35</sup> In *Wayfair*, the Court held that *Quill* mistakenly grounded the physical presence standard in *Complete Auto*’s substantial nexus requirement.<sup>36</sup> This incorrect interpretation is what led the *Wayfair* Court to overrule *Quill* and reexamine state tax collection on remote sellers under a correct interpretation of *Complete Auto*.<sup>37</sup>

The Court determined that stare decisis could not substantiate the barring of a valid implementation of the states’ sovereign power.<sup>38</sup> *Quill* was a ruling that helped stimulate the growth of internet shopping, for better or worse.<sup>39</sup> With the rise of e-commerce, websites were able to avoid collecting sales tax and leave paying a use tax up to consumers.<sup>40</sup> Consumers have a legal obligation to pay a use tax if sales tax is not collected on a sale by the retailer, but compliance rates are notoriously low at only an estimated four percent.<sup>41</sup> The internet caused the corrosion of the bright-line rule that *Quill* provided.<sup>42</sup> While the rise of the internet made it impossible for states to collect sales tax on remote sellers under *Quill*, it has eliminated the complex and burdensome process of offline tax collection.<sup>43</sup>

### III. ANALYSIS

In deciding *Wayfair*, the Court took the opportunity to overturn decades of precedent.<sup>44</sup> Retired Justice Sandra Day O’Connor says “the Supreme Court should generally follow its prior rulings so the public has confidence that laws

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34. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

35. *South Dakota v. Wayfair*, 138 S. Ct. 2080, 2091 (2018) (citing *Complete Auto*, 430 U.S. at 279).

36. *Id.* at 2092.

37. *See id.* at 2099.

38. *Id.* at 2096.

39. Liptak, *supra* note 17.

40. Boch, *supra* note 6, at 18.

41. *Wayfair*, 138 S. Ct. at 2088; Boch, *supra* note 6, at 18; Donnini II, *supra* note 3, at 82; Josh Barro, *The Supreme Court Decision that Will Put More Taxes on Internet Sales is Good News for You*, BUS. INSIDER (June 23, 2018, 10:33 AM), <https://www.businessinsider.com/supreme-court-wayfair-internet-sales-tax-decision-good-for-consumers-2018-6>.

42. Giovannini & Hedstrom, *supra* note 13, at 3.

43. Barro, *supra* note 41.

44. *Wayfair*, 138 S. Ct. at 2099.

do not change just because justices come and go.”<sup>45</sup> While overturning precedent is unusual for the Court, it is necessary to “focus on rules that are appropriate to the twenty-first century. . . .”<sup>46</sup>

#### A. *Unpractical Quill and Bellas Hess*

The overruling of *Quill* was driven by both doctrinal and policy considerations.<sup>47</sup> Doctrinally, *Quill*'s Commerce Clause reasoning was flawed because it incorrectly interpreted *Complete Auto*'s tax jurisprudence.<sup>48</sup> *Quill* also created, rather than resolved, market distortions when considering the modern functions of the economy.<sup>49</sup> The decision in *Wayfair* seeks to ground the Commerce Clause in a functional and dynamic modern marketplace.<sup>50</sup> *Quill* imposed an arbitrary and formalistic distinction that current day Commerce Clause precedents replaced with a case-by-case analysis that is more sensitive in nature.<sup>51</sup> For policy reasons, the Court wanted to eliminate the “judicially created tax shelter” that allowed interstate commerce retailers to avoid paying a fair share of taxes.<sup>52</sup> The physical presence standard “created an inefficient online sales tax loophole that gives out-of-state businesses an advantage.”<sup>53</sup> *Quill* was premised on unfounded assumptions and was “riddled with internal inconsistencies” that the Court in *Wayfair* sought to remedy.<sup>54</sup>

Technological advancements are the main reason that *Quill* is outdated in the modern marketplace.<sup>55</sup> The Court states that while *Quill* was wrong from its inception based on its interpretation of *Complete Auto*, the internet has made *Quill* “all the more egregious and harmful.”<sup>56</sup> Technology has interconnected the economy and brought buyers and retailers closer than ever before.<sup>57</sup> Under *Quill*, the continuous and pervasive virtual presence of retailers was irrelevant.<sup>58</sup>

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45. Hope Yen, *O'Connor: Court Should Follow Precedent*, WASH. POST (May 20, 2007, 9:59 PM), [http://www.washingtonpost.com/wp-dyn/content/article/2007/05/20/AR2007052000695\\_pf.html?noredirect=on](http://www.washingtonpost.com/wp-dyn/content/article/2007/05/20/AR2007052000695_pf.html?noredirect=on).

46. *Id.* at 2092.

47. Boch, *supra* note 6, at 19.

48. *Id.*

49. *Wayfair*, 138 S. Ct. at 2092.

50. *Id.* at 2095.

51. *Id.* at 2094.

52. Boch, *supra* note 6, at 19.

53. *Wayfair*, 138 S. Ct. at 2092.

54. *Id.*

55. *See id.* at 2093.

56. *Id.* at 2097.

57. *Id.* at 2095.

58. *Id.*

*Wayfair* considers modern technology and the fact that e-commerce is the way most consumers now make purchases.<sup>59</sup> Defendants argued it would be burdensome for out-of-state retailers to calculate and collect taxes due to the thousands of state and local laws enacted after *Wayfair*,<sup>60</sup> but the same technology that outdated *Quill* also helps retailers pay state sales tax.<sup>61</sup>

The bright-line rule of physical presence in *Quill* was shown to be an incorrect interpretation of the Commerce Clause and proved to be ineffective.<sup>62</sup> The Court in *Wayfair* seemed to recognize that any rule replacing the physical presence standard would need flexibility.<sup>63</sup> Often times, the law fails to keep up with technology and the physical presence standard was futile when faced with the changes in e-commerce.<sup>64</sup> The *Wayfair* ruling replaces the physical presence standard with an economic and virtual contacts test,<sup>65</sup> providing this flexibility. By not replacing physical presence with an alternative bright-line rule, the Court allows the law to evolve with ever-changing technology. A bright-line test does not work in the realm of interstate commerce because any attempt to apply it is unsound and unworkable in the present marketplace.<sup>66</sup>

States sought to circumvent *Quill* and successfully pushed it to its limits.<sup>67</sup> Some “enacted attributional nexus laws imputing the physical presence of in-state affiliates or independent contractors to the out-of-state seller.”<sup>68</sup> States also began distinguishing “income, gross receipts, or other business activity taxes, as distinct from sales and use tax collection obligations. . . .”<sup>69</sup> Newly enacted reporting statutes “required out-of-state sellers to provide notice and information if they chose not to collect taxes.”<sup>70</sup> Other cunning workarounds, such as New York’s click-through nexus provisions, and Massachusetts’ proposed regulation that would include internet cookies as part of the physical presence definition,

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59. Knoll, *supra* note 8.

60. See Liptak, *supra* note 17.

61. *Id.*; Tom Wheelwright, *How Will the ‘Wayfair’ Supreme Court Decision Affect Retailers? 5 Ways*, ENTREPRENEUR (July 17, 2018), <https://www.entrepreneur.com/article/316805> (discussing how the *Wayfair* decision will require retailers to create new systems to track and collect sales tax where required).

62. *Wayfair*, 138 S. Ct. at 2095.

63. See Giovannini & Hedstrom, *supra* note 13, at 2.

64. *Wayfair*, 138 S. Ct. at 2095.

65. *Id.* at 2099.

66. *Id.* at 2097.

67. Boch, *supra* note 6, at 18.

68. *Id.*

69. *Id.*

70. *Id.* at 19.



showed how desperate the states were under *Quill*.<sup>71</sup> *Wayfair* would have continued to spread these trends across the states if the Court had upheld the physical presence standard.<sup>72</sup>

The Court stated “the Commerce Clause was designed to prevent states from engaging in economic discrimination so they would not divide into isolated, separable units.”<sup>73</sup> *Quill* does not further this purpose because the only real results from the decision are relief of those engaged in interstate commerce from their share of tax burden and putting businesses on an uneven playing field.<sup>74</sup> Rejection of the physical presence standard in *Wayfair* was necessary to ensure that artificial competitive advantages are no longer created for businesses who do not physically cross state borders.<sup>75</sup> The Court in *Wayfair* furthers the true goal of the Commerce Clause by equalizing retailers when everyone is treated to the same tax collection obligation.<sup>76</sup>

Consumers, businesses, and states all had motivation to encourage the Court to overrule *Quill* in *Wayfair*.<sup>77</sup> The Court says that while *Quill* is unfair to consumers, competitors, and states, “there is nothing unfair about requiring companies that avail themselves of the States’ benefits to bear an equal share of the burden of tax collection.”<sup>78</sup> For consumers, the physical presence standard unfairly shifts the tax burden to consumers who buy from in-state sellers.<sup>79</sup> Those who choose to shop at their local downtown stores are taxed, while those who buy from distant online websites are relieved of that burden.<sup>80</sup> “[T]he physical presence rule undermines [the] necessary confidence” in the tax system by creating inequitable exceptions that give some online retailers an arbitrary advantage.<sup>81</sup> By allowing out-of-state sellers to avoid collecting and remitting

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71. Gail Cole, *Massachusetts Internet Cookie Tax Will be Fully Baked on October 1*, (Sept. 22, 2017), <https://www.avalara.com/taxrates/en/blog/2017/09/massachusetts-internet-cookie-tax-will-be-fully-baked-on-october-1.html>; Corey L. Rosenthal et al., *Understanding Click-Through Nexus*, CPA JOURNAL (Jan. 22, 2017), <https://www.cpajournal.com/2017/01/22/slt-understanding-click-through-nexus/>.

72. See Boch, *supra* note 6, at 19.

73. *South Dakota v. Wayfair*, 138 S. Ct. 2080, 2093–94 (2018).

74. See *id.* at 2094.

75. *Id.*

76. Mark Walsh, *Argument Analysis: Justices are Divided on Whether to Overrule Precedents on Sales-Tax Collection by Remote Sellers*, SCOTUSBLOG (April 17, 2018, 6:05 PM), <http://www.scotusblog.com/2018/04/argument-analysis-justices-are-divided-on-whether-to-overrule-precedents-on-sales-tax-collection-by-remote-sellers/>.

77. See *Wayfair*, 138 S. Ct. at 2094, 2096.

78. *Id.* at 2096.

79. *Id.*

80. See *id.*

81. *Id.*

sales tax, they are given the upper hand.<sup>82</sup> This prevents market participants from competing on a uniform field.<sup>83</sup> Small businesses with a physical presence are harmed because online retailers can offer de facto lower prices when a state sales tax is not included, which looks more appealing to consumers.<sup>84</sup> By declining to collect sales tax, e-commerce sites are given an “end-price advantage at the transaction stage.”<sup>85</sup> Essentially, businesses who choose to operate under one organizational form are given a competitive benefit.<sup>86</sup> Businesses of relatively the same size are treated differently if one has a diverse physical presence and the other operates only online from a single physical location.<sup>87</sup> Also, a small business may be heavily burdened compared to a large remote seller, simply because they chose a different business structure.<sup>88</sup> The physical presence standard shows favoritism to mail order sellers over the traditional brick and mortar.<sup>89</sup> If *Wayfair* and the decision to replace the physical presence rule happened earlier, it is possible that brick-and-mortar sellers could have stayed relevant longer, instead of being quickly eliminated by tax-free e-commerce.<sup>90</sup> However, the marketplace may already be addressing this problem since many of the big sellers have warehouses, and therefore a physical presence, in almost every state.<sup>91</sup> This argument still ignores the smaller states who collect the least amount of revenue from online retailers, but who are losing revenue rapidly.<sup>92</sup> If states are unable to collect sales tax, “the government either has to cut back on services or it has to raise taxes on something else.”<sup>93</sup> Many states are facing poor fiscal conditions and are continuing to lose much needed sale tax revenues, which limits the ability to seek long-term prosperity.<sup>94</sup> The incentive to avoid having a physical presence that was created by *Quill* hurts consumers, businesses, and states through the lack of storefronts, distribution points, and employment centers that would otherwise be efficient or desirable.<sup>95</sup>

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82. *See id.*

83. *Id.*

84. *Wayfair*, 138 S. Ct. at 2094; *see* Walsh, *supra* note 76.

85. Walsh, *supra* note 11.

86. *Wayfair*, 138 S. Ct. at 2094.

87. *Id.* at 2093.

88. *See id.*

89. Boch, *supra* note 6, at 18; *see* Walsh, *supra* note 76.

90. Alana Semuels, *Will a New Supreme Court Decision Change Online Shopping?*, ATLANTIC (June 21, 2018), <https://www.theatlantic.com/technology/archive/2018/06/what-the-supreme-courts-decision-on-online-sales-tax-means/563405/>.

91. *See* Liptak, *supra* note 16; Walsh, *supra* note 76.

92. 92.#92.#*See* Donnini II, *supra* note 3, at 83; *See Wayfair*, 138 S. Ct. at 2097.

93. Barro, *supra* note 41.

94. Walsh, *supra* note 76; *see Wayfair*, 138 S. Ct. at 2096.

95. *Wayfair*, 138 S. Ct. at 2094.

### B. *Stare Decisis No Longer an Excuse for Inaction*

The Court often declines to reconsider previous decisions under the doctrine of stare decisis in order to preserve continuity and stability in the law.<sup>96</sup> Unlike the dissenting justices, the majority in *Wayfair* found that stare decisis could no longer maintain prohibition of the states' exercise of lawful sovereign powers.<sup>97</sup> While Congress may have the authority to change the physical presence standard, it would be inconsistent with the "Court's proper role to ask Congress to address a false constitutional premise."<sup>98</sup> The physical presence standard was created through constitutional interpretation by the Court.<sup>99</sup> To ask Congress to fix the Court's own misconstruction would be illogical. Justice Sandra Day O'Connor said, "the Supreme Court should generally follow its prior rulings so the public has confidence that laws do not change just because justices come and go."<sup>100</sup> However, the law ought to be able to rapidly adapt to social changes and stare decisis may prevent important legal adaptations. In *Wayfair*, the Court recognized the harm inflicted upon the states was great enough to warrant a change in the law.<sup>101</sup>

### C. *Economic and Virtual Contacts as an Appropriate Test*

*Wayfair* appears to have replaced physical presence with an economic and virtual contacts test.<sup>102</sup> This standard includes two distinct, but related tests.<sup>103</sup> The economic nexus test is satisfied when a business meets or exceeds the individual thresholds established by each state.<sup>104</sup> South Dakota's economic nexus threshold of \$100,000 or more in sales or two hundred or more transactions provides a clear framework for businesses and states alike.<sup>105</sup> As a result, states are quickly implementing or updating their own statutes and regulations.<sup>106</sup> However, "the Court did not hold that South Dakota's economic nexus thresholds as new constitutional minimums," so states may face future litigation

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96. *See* Yen, *supra* note 45.

97. *Wayfair*, 138 S. Ct. at 2096.

98. *Id.*

99. *Id.* at 2090.

100. Yen, *supra* note 45.

101. *Wayfair*, 138 S. Ct. at *passim*.

102. *Wayfair*, 138 S. Ct. at 2099; Giovannini & Hedstrom, *supra* note 13, at 2.

103. Giovannini & Hedstrom, *supra* note 13, at 2.

104. *Wayfair*, 138 S. Ct. at 2099.

105. Boch, *supra* note 6, at 19–20.

106. *Id.* at 20.

if enacted thresholds are lower than South Dakota's.<sup>107</sup> The Court agreed that "the sale of goods or services 'has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State.'"<sup>108</sup> The new virtual contacts interpretation of the substantial nexus requirement "suggests a balancing test between the taxpayer's real or virtual presence and the administrative burdens of a tax system."<sup>109</sup> Unlike the physical presence standard, the websites of businesses that maintain an extensive virtual presence satisfy the nexus requirement and may be required to collect taxes on sales.<sup>110</sup> The virtual presence test is highly subjective because the sophistication of a website may or may not satisfy the substantial virtual presence standard.<sup>111</sup> The Court provided some guidance as to what constitutes virtual presence by website accessibility, presence of cookies, and the ability to download applications, though questions remain as to what other virtual characteristics may satisfy this requirement.<sup>112</sup>

#### D. *Problems Solved by Wayfair*

*Wayfair* solves many of the problems businesses, states, and society faced under *Quill* and the physical presence standard.<sup>113</sup> For brick-and-mortar businesses, the rapid decline of the traditional retail model is slowed.<sup>114</sup> Consumers may no longer have a choice where they can avoid state sales tax, but this may encourage them to start going back to physical stores.<sup>115</sup> Brick-and-mortar businesses are put on a more level playing field and consider the decision in *Wayfair* to be a victory.<sup>116</sup> Startups and small businesses are protected by *Wayfair* and the economic and virtual contacts test because only those doing a considerable amount of business in the state are taxed, and the law does not apply retroactively.<sup>117</sup>

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107. Giovannini & Hedstrom, *supra* note 13, at 2.

108. *Wayfair*, 138 S. Ct. at 2092 (citing *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184 (1995)).

109. Boch, *supra* note 6, at 18.

110. *Id.* at 19–20.

111. Giovannini & Hedstrom, *supra* note 13, at 2.

112. *Id.* at 4.

113. *See Wayfair*, 138 S. Ct. at 2092.

114. Boch, *supra* note 6, at 20.

115. Wheelwright, *supra* note 61.

116. Liptak, Casselman & Creswell, *supra* note 19.

117. *Wayfair*, 138 S. Ct. at 2098.

Through the economic and virtual contacts test, the states may now improve tax enforcement.<sup>118</sup> States may apply the test and collect taxes from “e-commerce companies across the US and foreign businesses selling into the country.”<sup>119</sup> *Quill* allowed businesses with no permanent establishment in the U.S. to gain a competitive advantage over U.S. based companies.<sup>120</sup> Now, international businesses may be brought into the costly domain of multi-state compliance.<sup>121</sup> It seems only fair that these sellers bear their share of the tax burden if seeking the benefit of selling within the U.S. However, states may find collection from foreign businesses problematic because of the difficulty in getting these retailers to abide by U.S. laws.<sup>122</sup> The billions of dollars lost every year by states may seem insignificant when the annual collection of taxes is approximately \$1.6 trillion, but collection of only another half-percent of this amount is significant in closing the budget gap.<sup>123</sup>

More broadly, the decision in *Wayfair* encourages the law to progress alongside society by focusing on “rules that are appropriate to the twenty-first century, not the nineteenth.”<sup>124</sup> It is now possible for states to increase sales tax revenue without increasing tax rates on all taxpayers.<sup>125</sup> This decision will benefit the economy and those “who rely on services from state governments, which is everyone.”<sup>126</sup>

The Commerce Clause demands that a state’s authority not discriminate or excessively burden out-of-state sellers.<sup>127</sup> If a law does not abide by these boundaries, it faces a per se rule of invalidity.<sup>128</sup> There are measures in South Dakota already in place to ensure that a sales tax collection law is not discriminatory or unduly burdensome.<sup>129</sup> These include “[a] safe harbor threshold for those that transact only limited business in the state . . . [a] guarantee that the law will not be applied retroactively. . . [and] uniform

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118. See Liptak, Casselman & Creswell, *supra* note 19.

119. Stanley-Smith, *supra* note 4.

120. *Id.*

121. *Id.*

122. Semuels, *supra* note 90.

123. See Barro, *supra* note 41 (indicating that states and localities collected \$1.6 trillion in taxes as of 2015).

124. *South Dakota v. Wayfair*, 138 S. Ct. 2080, 2092 (2018) (citing Walter Hellerstein, *Deconstructing the Debate Over State Taxation of Electronic Commerce*, 13 HARV. J.L. & TECH. 549, 553 (2000)).

125. Barro, *supra* note 41.

126. *Id.*

127. *Id.*

128. *Wayfair*, 138 S. Ct. at 2091 (citing *Granholm v. Heald*, 544 U.S. 460, 476 (2005)).

129. *Id.* at 2099.

definitions and centralized administration of state and local taxes.<sup>130</sup> The Court found that South Dakota ensured it followed Commerce Clause requirements by making software available for free to out-of-state retailers to aid in compliance and the creation of one centralized agency for tax collection.<sup>131</sup> The economic and virtual contacts test defined in *Wayfair* and the measures implemented to ensure compliance with the Commerce Clause will promote economic prosperity of businesses, states, and society.

E. *Subsequent Action by Businesses, States, and Congress*

Following the Court's decision in *Wayfair*, businesses, states, and Congress must now engage in decision making and action not previously contemplated under the physical presence standard.<sup>132</sup> *Wayfair* has an effect on almost every business selling across state lines.<sup>133</sup> Businesses must now begin collecting sales tax in those states which have economic and virtual nexus laws in effect, if they satisfy the thresholds.<sup>134</sup> It is inevitable that states will enact such laws and in response many businesses have already begun registering for sales tax nationwide.<sup>135</sup> Smaller remote businesses may find themselves close to the economic and virtual thresholds set by each state, so they must monitor the laws of every state where they are conducting business.<sup>136</sup> E-commerce sites that bring together individual sellers, such as Etsy, already automatically collect a sales tax on out-of-state transactions without involving the seller.<sup>137</sup> Wholesalers, service providers, and cloud-based services should also closely monitor the laws of various states where they conduct business.<sup>138</sup> Economic and virtual nexus laws, such as South Dakota's, may apply to wholesalers when the law does not differentiate between taxable and exempt sales.<sup>139</sup> While services are generally nontaxable, state law varies as to what services are taxable, and service providers should proceed carefully.<sup>140</sup> The Court's failure to provide a precise definition of

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130. Giovannini & Hedstrom, *supra* note 13, at 5.

131. Barro, *supra* note 41.

132. *See generally* Boch, *supra* note 6.

133. *Id.* at 20.

134. *Id.*

135. *Id.*

136. *Id.*

137. *How State Sales Tax Applies to Etsy Orders*, ETSY HELP CTR., <https://help.etsy.com/hc/enus/articles/360000343968-How-State-Sales-Tax-Applies-to-Etsy-Orders> (last visited Feb. 28, 2019).

138. Boch, *supra* note 6, at 20.

139. *Id.*

140. *Id.* at 22.

virtual presence makes compliance for cloud-based businesses difficult.<sup>141</sup> Many of these businesses used the physical presence standard for protection, but under *Wayfair*, many should err on the side of collection.<sup>142</sup> State economic and virtual nexus laws may closely mirror one another, but remote retailers have to pay close attention to each individual state as variations are likely.<sup>143</sup> The burden on businesses to ensure compliance with state laws is a small price to pay for the benefit attained by availing themselves within the state.

Almost immediately after *Wayfair*, states began updating laws and regulations to take advantage of the redefined and consequently expanded taxing power.<sup>144</sup> Many states are now deciding how to constitutionally develop and apply an economic and virtual nexus law.<sup>145</sup> It is likely that all states will soon have laws similar to South Dakota's, in order to increase state revenues that are desperately needed nationwide.<sup>146</sup> The Court in *Wayfair* did not provide constitutional minimums for thresholds, so states must consider that any law enacted could face its own legal challenges.<sup>147</sup> The law of South Dakota did not apply retroactively, which was a factor considered by the Court in upholding it.<sup>148</sup> Most states are taking a similar prospective-only approach, but it is unknown if a state law applying a state tax retroactively is constitutional.<sup>149</sup> If states enacting economic and virtual nexus laws want to be sure the statute is valid, South Dakota's law and implementation of it should be followed as much as possible.<sup>150</sup>

While congressional action is possible, it is unlikely because the opportunity to change the physical presence rule was never taken, and states have been responding favorably to *Wayfair*.<sup>151</sup> In fact, the remote sellers in *Wayfair* welcomed a decision from the Court that would ““indicate that Congress should move forward with consideration and action upon legislation.””<sup>152</sup> It is likely these businesses believed congressional inaction would continue and they would remain free of state sales tax for years to come. During the proceedings of *Wayfair*, many members of Congress were present and wanted to see *Quill*

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141. *See id.* at 20.

142. *Id.*

143. *See* Boch, *supra* note 6, at 20; Knoll, *supra* note 8.

144. *See* Boch, *supra* note 6, at 20.

145. *See id.*

146. Wheelwright, *supra* note 61.

147. *See* Liptak, Casselman & Creswell, *supra* note 19.

148. *See* South Dakota v. Wayfair, 138 S. Ct. 2080, 2099 (2018).

149. *See id.*; Boch, *supra* note 6, at 20.

150. Barro, *supra* note 41.

151. Boch, *supra* note 6, at 22.

152. Walsh, *supra* note 76 (quoting George Isaacson, the lawyer representing the retailers).

overruled.<sup>153</sup> In an amicus brief filed by a group of U.S. Senators, it was argued that “Congress has been unable to ‘reach a consensus’ on a legislative solution, in part because of *Quill*.”<sup>154</sup> The inaction of congress may also be a result of “a feared reaction to a perceived ‘new’ internet tax from which the federal government receives little or no benefit.”<sup>155</sup> Since *Wayfair*, Congress is now able to address and declare a minimum threshold for state sales tax collection.<sup>156</sup>

#### F. *Questions Remaining*

*Wayfair* leaves many questions unanswered, including what constraints persist regarding state taxing power.<sup>157</sup> Some have argued that small businesses that sell on e-commerce sites with multiple individual sellers, such as Amazon, eBay, and Etsy, may see a drop in profit.<sup>158</sup> However, states have already enacted laws requiring internet retailers to collect tax on third party sales and most of these types of businesses are collecting the tax.<sup>159</sup> Even Wayfair, Inc. said it already collected on approximately 80 percent of its U.S. orders, and the Court’s decision in this case was not expected to have any noticeable impact on company business.<sup>160</sup>

As previously stated, it is unclear whether a law that applies retroactively will be constitutional after *Wayfair*, even after the Court strongly suggested states follow the South Dakota framework.<sup>161</sup> If a law does apply retroactively, businesses may face potential audit exposure for prior years.<sup>162</sup> Again, states will be gambling with constitutionality if they apply an economic and virtual nexus law retroactively.<sup>163</sup> Thus far, “[thirty-eight] other states have indicated that their laws would prevent retroactivity”<sup>164</sup> because they do not want to address it.<sup>164</sup>

Since states do not have to copy South Dakota exactly, questions remain as to what economic and virtual thresholds states will enact.<sup>165</sup> Many states may first have to simplify the state tax system in order to make sales tax collection on

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153. *Id.*

154. Semuels, *supra* note 90.

155. Donnini II, *supra* note 3, at 83.

156. *See* Knoll, *supra* note 8.

157. Boch, *supra* note 6, at 19.

158. *E.g.*, Wheelwright, *supra* note 61.

159. *See* Liptak, Casselman & Creswell, *supra* note 19.

160. *Id.*

161. Boch, *supra* note 6, at 20.

162. *Id.*

163. *See* Giovannini & Hedstrom, *supra* note 13, at 5.

164. Walsh, *supra* note 76.

165. *See* Boch, *supra* note 6, at 20.



remote retailers possible.<sup>166</sup> While questions remain, *Wayfair* provides the flexibility that is necessary to allow the law to change with commerce.

### G. *Dissent Reasoning is Unsound*

*Wayfair* is “in direct conflict with roughly 50 years of Supreme Court precedent.”<sup>167</sup> This was a major sticking point for the dissenting justices.<sup>168</sup> The dissent agreed that the Court’s rulings in the area of the physical presence rule of the Commerce Clause were wrongly decided, but believed there were not enough reasons to overrule precedent.<sup>169</sup> Chief Justice Roberts, speaking for the dissent, claimed that a shift in the economy is not reason enough for the Court to overturn such long standing precedent.<sup>170</sup> It would seem that the dissent’s pride was too great to allow them to consider overruling obsolete law that no longer functions in today’s society. If the law does not develop alongside society, stagnation occurs in both. The dissent chooses to continue down the path of *Quill* by turning to Congress for action.<sup>171</sup> Turning to Congress to fix incorrect judicial constitutional interpretation is not a proper role for either the judicial or legislative branches of government.<sup>172</sup>

## IV. CONCLUSION

For the first time in more than twenty-five years, the Supreme Court granted certiorari for a sales tax collection case.<sup>173</sup> The Court in *Wayfair* reinterpreted the Commerce Clause and replaced the previous physical presence standard with the economic and virtual nexus test.<sup>174</sup> By allowing states to collect sales tax from remote out-of-state sellers, *Wayfair* is likely to have a substantial fiscal impact.<sup>175</sup> It is estimated that there will be between \$8 to \$13 billion in revenue gained by the states under the expanded tax authority of the economic and virtual nexus test.<sup>176</sup> Out-of-state sellers are no longer able to avoid paying sales tax by hiding

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166. *Id.*

167. Donnini II, *supra* note 3, at 82.

168. *See* South Dakota v. Wayfair, 138 S. Ct. 2080, 2102 (2018).

169. Liptak, Casselman & Creswell, *supra* note 19.

170. Donnini II, *supra* note 3, at 83

171. *See id.*

172. *Wayfair*, 138 S. Ct. at 2096.

173. Donnini II, *supra* note 3, at 82.

174. Giovannini & Hedstrom, *supra* note 13, at 1.

175. Boch, *supra* note 6, at 20.

176. *Id.*

behind the physical presence rule that was mandated by earlier cases.<sup>177</sup> *Wayfair*, in overruling *Quill*, did not offer a clear alternative, but the Court used the analysis of the South Dakota law to provide guidelines.<sup>178</sup> Continued controversy and development is expected as states take the opportunity to expand their taxing powers on remote retailers.<sup>179</sup> *Wayfair* grants autonomy to the states to exercise their power under the Commerce Clause, while keeping the delicate balance of power between states and Congress. Through bipartisan support, the Court was urged to reinterpret the Commerce Clause while considering the prevalence of e-commerce.<sup>180</sup> *Wayfair* brings the law into the modern-day marketplace and allows states to collect much needed revenue from retailers who have strategically been avoiding the law.<sup>181</sup>

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177. *See id.*, at 19.

178. *Id.* at 22.

179. *Id.*

180. *See* Liptak, Casselman & Creswell, *supra* note 19.

181. Boch, *supra* note 6, at 19, 22.