

# Supreme Court Overturns *Quill* and Broadens Businesses' Tax Collection Obligations

## *Elimination of Physical Presence Standard Leaves Unanswered Questions*

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Tax

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For only the third time in the last fifty years, the Supreme Court has ruled on whether a state may compel a remote, out-of-state seller to collect and remit that state's sales tax on purchases made by in-state customers. In *South Dakota v. Wayfair, Inc.* 585 U.S. \_\_\_\_ (2018), the Court held that a state indeed may compel sales tax collection and remittance by a remote seller. This decision overturns two earlier Supreme Court decisions on this subject—*National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)—and eliminates the physical presence requirement established by those prior cases.

### ***Wayfair*—A 5 to 4 Decision**

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Under *Bellas Hess* and *Quill*, the Court had held that a state may not require a business with no in-state physical presence to collect its sales tax. (Typically, physical presence is established by in-state business property or personnel.) In *Wayfair*, the Court ruled 5-4 that the physical presence standard of *Bellas Hess* and *Quill* was not constitutionally mandated. The Court noted that *Quill* was flawed on its own terms, as it created market distortions by serving as a “judicially created tax shelter” for businesses that limit their physical presence to certain states. The Court also noted that in the modern U.S. economy, *Quill*'s physical presence test had become artificial and imposed a significant limitation on the ability of states to exercise their sovereign taxing authority over online and other out-of-state sellers.

The Court in *Wayfair* reaffirmed the standard for analyzing the validity of state tax obligations under the Commerce Clause of the U.S. Constitution (a standard that was first announced in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)). This standard includes four tests, the most important of which is that tax obligations may be imposed on a business only if the business has a “substantial nexus” with the taxing state. The Court in *Wayfair* remanded the case to the South Dakota courts to determine whether the South Dakota statute, which imposes a sales tax collection obligation on any seller generating at least \$100,000 of receipts from in-

state sales or making at least 200 separate in-state deliveries, satisfies all the *Complete Auto Transit* tests in the absence of a physical presence requirement.

## **Unanswered Questions After *Wayfair*—Uncertainty Over Nexus Thresholds For State Sales and Income Taxes**

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The Court's decision in *Wayfair* leaves several questions unanswered. One major question is whether some minimal level of sales activity is necessary to satisfy the "substantial nexus" standard under *Complete Auto Transit* for sales tax purposes. The Court found that the thresholds in South Dakota's law (\$100,000 of sales or 200 deliveries) satisfied the "substantial nexus" test. However, the Court does not describe whether some lower thresholds—perhaps significantly lower—might satisfy this standard. Accordingly, other states might test the limits of the Court's holding by imposing lower thresholds upon remote sellers.

Other unanswered questions relate to *Wayfair*'s effect on different nexus requirements related to state tax regimes other than those governing sales taxes, such as those involving income taxes, withholding taxes, and information reporting. States, emboldened by the *Wayfair* decision, might seek to enact new laws, or more actively enforce already existing rules, related to these other state tax regimes against businesses with only in-state economic presence (that is, businesses without in-state physical presence). For instance, a jurisdiction now might insist that a company with no physical presence must pay that jurisdiction's income tax on the company's profits if that business makes more than de minimis merchandise sales to customers located there. While this approach was available to states prior to the *Wayfair* case, the decision provides strong support to any jurisdiction seeking to enact or enforce properly scoped "economic nexus" rules against remote businesses.

## **Looking Ahead—Sales Tax Planning**

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In the coming months, taxing jurisdictions are likely to announce their rules on minimum sales tax "nexus" thresholds (i.e., the number of transactions and/or the dollar value of sales receipts in the jurisdiction) applicable to remote sellers. Jurisdictions might also announce effective dates for their enforcement on remote sellers of the obligations to collect and remit sales taxes. Because the *Wayfair* decision provides no binding guidance on these issues, the taxing jurisdictions have some latitude regarding where they set their bars. This could conceivably include adopting "single sale" nexus rules and retroactive effective dates.

Perhaps the most vulnerable remote sales now subject to state tax collection are sales of tangible personal property. The vulnerability stems from the fact that virtually all taxing jurisdictions impose tax on sales of tangible personal property. Remote sellers should consider when they might begin collecting tax on these sales. Even in jurisdictions where the remote business engages in relatively few sales of tangible personal property, there is risk that the taxing jurisdiction will enforce a tax collection and remittance obligation. The financial impact to the remote seller who chooses to not collect the tax intensifies as the value and volume of sales activity in the jurisdiction increases. Just as one example, remote sellers of luxury items (such as jewelry stores or art houses) should pay particular attention to changes and updates to the new sales tax landscape.

In addition, remote businesses that sell services or digital goods should consider whether tax might be due on these sales in states where they have no physical presence. For instance,

businesses now must consider whether to impose sales tax on sales of streaming video or other digital content to customers located in a state other than where the seller is located. The taxability of these sales is typically much less certain than the taxability of sales of tangible personal property; however, the seller's lack of physical presence in a jurisdiction will no longer suffice to completely shield these transactions from the sales tax rules. Remote sellers of these items likely will need to consult with their tax advisors to determine how the various jurisdictions tax these types of sales.

Finally, now that significantly more transactions might be subject to sales tax, all businesses should review their internal policies and their third-party agreements (with sales agents, joint venturers, and the like) to understand, and perhaps fortify, the provisions regarding (i) who has the responsibility for collecting sales taxes (and any related indemnity provisions), (ii) for how long documents relevant to a sales tax obligation should be retained, and (iii) how the parties will manage due diligence and audit efforts.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Tax practice:

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