US Supreme Court hears oral arguments in the online sales tax case, South Dakota v. Wayfair

TAX AND BENEFITS CHALLENGES | APR 26, 2018

Last week, lawyers involved in the "online sales tax case of the millennium," as Bloomberg described it, finally got to present their arguments in front of the United States Supreme Court. Below we recap the oral argument held in *South Dakota v. Wayfair,* on April 17, 2018. The court's decision is expected by the end of June.

The *South Dakota v. Wayfair* case addresses the power of states to require out-of-state retailers to collect sales and use tax from their consumers. Historically the U.S. Supreme Court has required remote retailers to have a physical presence in the taxing state to trigger a collection duty. The court last addressed the issue in the 1992 case *Quill Corp. v. North Dakota,* in which North Dakota attempted to impose the collection duty on a company that marketed its products by direct mail. The court in *Wayfair* is considering whether the *Quill* case and its physical presence standard are still good law.

Since the *Quill* case was handed down in 1992, the rise of the interent and e-commerce has transformed the economy and provided a new factual context to evaluate the physical presence requirement. Rather than address the direct mail industry per se, the court in *Wayfair* is focused instead on whether a recently enacted South Dakota law may impose use tax collection duties on internet retailers without a physical presence in South Dakota. Because a South Dakota law asserts substantial nexus with internet retailers due to the sales volume only (i.e., $100,000 in sales delivered to South Dakota or at least 200 transactions), the standard that South Dakota alleges is often referred to as "economic nexus." Our March 1, 2018 article announcing the oral argument provides additional background on the case.

At oral argument, the key concerns focused on the possible avalanche of new litigation if *Quill* is overturned, what the new nexus standard should be and whether it should be retroactive, and whether, if ever, precedent, should be overturned. One exchange centered on the argument of the attorney for the internet retailers that even when a precedent is wrong, it should stand firm because of the value of settled expectations and the stare decisis doctrine.

Following the oral argument, some observers were surprised that there does not appear to be a solid five-justice majority favoring South Dakota. Many commentators expect that Justices Clarence Thomas, Anthony Kennedy, Neil Gorsuch, and potentially Ruth Bader Ginsberg will vote in favor of South Dakota, while Justice Samuel Alito will likely favor the internet retailers' side. However, it is still speculation at this point how any justice will vote until the court's decision is ultimately issued.

SOUTH DAKOTA'S POSITION

South Dakota's Attorney General Marty Jackley went first for the petitioner, South Dakota, and quickly summed up the stakes as he saw them: "First, our states are losing massive sales tax revenues that we need for education, healthcare, and infrastructure. Second, our small businesses on Main Street are being harmed because of the unlevel playing field created by *Quill*, where out-of-state remote sellers are given a price advantage."

South Dakota wants to be able to tax online purchases in accordance with its legislation on the issue, the constitutionality of which is the dispute in this case.

As soon as Attorney General Jackley finished his sentence, Justice Sonia Sotomayor jumped in to assert that *Quill* is not the problem, it's the act of tax collecting; she suggested that South Dakota should simply "find a way" to do that. She was concerned "about the many unanswered questions that overturning precedents" would generate, and the resulting "massive amounts" of related lawsuits. She stated there are questions such as retroactivity (i.e., states asserting back taxes over companies that did not collect tax due to their reliance on the *Quill* physical presence rule), what kind of contact and how much in sales it would take to impose the collection obligation, what to do if merchants cannot keep track of whom they've sold to, and the implementation and administrative costs on small business.

Justice Alito chimed in right away also, asserting that there are two possible solutions: eliminating *Quill*, or letting Congress deal with it. Attorney General Jackley indicated a preference for the first, noting that Congress has had 26 years to address the matter but has not. Justice Elena Kagan responded that when Congress decides not to act, the court is reluctant to do so. And according to Justice Stephen Breyer, "[t]he reason that we say we are more willing to overturn a constitutional case is because Congress can't act. But, here, they can act."

Justice Breyer moved on to express his own quandary: "When I read your briefs, I thought absolutely right. And then I read through the other briefs, and I thought absolutely right. And you cannot both be absolutely right."

He went on to emphasize a few of Justice Sotomayor's questions: how to quantify lost use tax revenue because remote retailers do not collect it, retroactivity, and what the standard with respect to a retailer's connection to a state should be. Attorney General Jackley responded that there will be about $100 billion in lost revenue in the next decade, and that most states are not seeking retroactive tax collections. He ran out of time before he could address his proposal for the nexus standard.

IN SUPPORT OF SOUTH DAKOTA

Next up was Malcolm Stewart, the Deputy United States Solicitor General at the Department of Justice, as a friend of the court in support of South Dakota. He started by emphasizing that "Congress can act. Congress can impose whatever solution it believes is appropriate." What is more, giving states the leeway to experiment as they see fit would give the federal body "a wider variety of models to look at to decide what aspects of each it would like to -- to choose." Justice Sotomayor was unsatisfied with this, because it does not solve the problem of all the lawsuits that she fears would be filed until Congress acts.

Stewart then pivoted, emphasizing that an "out-of-state retailer who is deliberately selling a particular physical good within the state, shipping the good into the state for delivery to the

customer and transfer of title, that is a sufficient basis for subjecting that retailer to the tax collection obligation." In essence, Stewart was proposing that states have nexus with retailers where they "purposefully avail" themselves of the state's marketplace.

THE INTERNET RETAILERS' PERSPECTIVE

Following Stewart was George Isaacson on behalf of the internet retailers. He opened by suggesting that according to the General Accountability Office, the $100 billion in tax revenue figure that Jackley alleged states forgo due to *Quill* accounts only for one-third to one-fourth of the actual losses. To this Justice Breyer threw up his hands in exasperation with the briefs' diverging facts on this and other figures: "How do I decide who's right?"

Then Justice Ginsburg broke in, wondering about competition: "[Isn't] asking an out-of-state seller to collect tax on goods shipped in-state discriminates…equalizing rather than discriminating?" To which Isaacson declared that while the Dormant Commerce Clause seeks "the maintenance of a single national marketplace that is free and accessible to all participants," the fact that there are thousands different taxing jurisdiction-with different rates and exemptions-burdens interstate commerce, and moreover, is getting worse.

Unsatisfied with this, Justice Gorsuch contended that if a retailer chooses to do business in a given jurisdiction, why should it not be subject to its rules? "Why should we favor" those who do not have bricks and mortar over those that do?

Isaacson suggested that the solution would be for Congress to act; it can require "one rate per state for all remote sales." At this point, Chief Justice Roberts voiced his thought that it "would be very strange for us to tell Congress it ought to do something in any particular area." Justice Ginsberg further stated: "Why shouldn't the Court take responsibility to keep our case law in tune with the current commercial arrangements?"

Isaacson tried to bolster his stance by highlighting practical problems that would come about if the court reversed itself, like a retailer having to look up the tax rates for 12,000 different taxing jurisdictions. Justices Kagan and Ginsberg seemed to assume that Amazon and its ilk would take care of these problems for the sellers with software, a point that Isaacson disputed. Once again, the conversation had turned to the *Quill* precedent, retailers' reliance on it, and how a new, different rule would affect small businesses.

SOUTH DAKOTA'S REBUTTAL

The justices spent the last five minutes revisiting the question of what nexus standard should apply were the court to agree in principle with South Dakota. Justice Breyer repeated the previously mentioned concern about the avalanche of litigation, and compliance costs: "I suddenly think of 10,000 cases being brought by 20,000 lawyers on one side and another 20,000 on the other to decide jurisdiction by jurisdiction, case by case about whether that test is met."

Attorney General Jackely persisted in his quest for overturning *Quill*:

"If you truly want to protect the small sellers, *Quill* doesn't do that…A statute such as South Dakota's does. It sets a reasonable limit of $100,000 and 200 specific transactions….Small businesses are not being treated fairly. We're not asking remote sellers to do anything that we're not already asking our small businesses to do in our state. And that is simply to collect and remit a tax."

CONGRESSIONAL ACTION?

There are several bills currently pending in Congress that would "replace the physical presence standard with one that prevents taxation based on nondirected and transient activity such as internet cookies, referral links, and airport stopovers."

These bill include:

- **The Mobile Workforce Bill,** which would limit the imposition of state income taxes to those physically present in the state for at least 30 days (many now tax from day 1).
- **The Business Activity Tax Simplification Act**, requiring a threshold of activity in the state before corporate or gross receipt tax is owed.
- **The Digital Goods and Services Tax Fairness Act**, defining which one state (the address of the purchaser) gets to tax digital transactions that are everywhere and nowhere.

Another bill, H.R. 2193, the Remote Transactions Parity Act of 2017, would have allowed states to collect sales taxes on internet sales. But, according to Bloomberg, it "recently fell short in a last-minute attempt to persuade lawmakers to include a digital tax provision in a federal omnibus spending bill signed by President Trump March 23."

As mentioned, the court's decision is expected by the end of June.

DAVID KALL

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