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Supreme Court Will Decide If States Can Require Sellers With No Physical Presence to Collect Sales and Use Tax

The Supreme Court has held in two separate cases decided in 1967 and 1992 that the interstate commerce clause of the U.S. Constitution prohibits a state from requiring an out-of-state vendor who solicits sales by mail-order catalogues to collect use tax for sales made to customers in that state when the vendor lacked outlets, sales representatives, or other significant property in the state. Those two cases were *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) and *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967). In so doing, the Supreme Court established a ‘‘bright line’’ physical presence test. Without physical presence, the seller does not have ‘‘substantial nexus’’ with a state and cannot be required to collect its use tax.

In *National Bellas Hess*, the taxpayer was a mail-order house with its main office in Missouri. It was licensed to transact business in Missouri and Delaware only. It had no outlets, sales representatives, tangible property, warehouses, distribution places, or telephone listing in Illinois. It did not advertise in Illinois by billboard, newspaper, television, or radio. Its sole contact with the state was that it mailed catalogues to its residents twice annually and supplemented them with more frequent mailings of promotional brochures. National Bellas Hess customers mailed their orders to the company, which had them filled by U.S. mail or common carrier. Illinois asserted that National Bellas Hess had an obligation to collect the use tax from Illinois consumers and remit payment to the state.

On these facts, the Supreme Court held that the Fourteenth Amendment and the interstate commerce clause prohibited a state from imposing the duty of use tax collection and payment on a company whose only connection with that state was by U.S. mail or common carrier. The Court found that the constitution required *physical presence* in the state before that state could impose a duty to collect and remit its use tax.

Twenty-five years later, the Supreme Court affirmed its holding in *National Bellas Hess* in *Quill Corp.* Quill is a Delaware corporation that sells office supplies through its catalogue. The company had offices in Illinois, California, and Georgia. Like National Bellas Hess, it had no physical presence in North Dakota, the state that was attempting to impose its use tax collection obligation, although it did license certain software to customers in North Dakota to allow the customers to check Quill’s inventory of various products. Quill’s ownership of personal property in North Dakota was thus either insignificant or nonexistent. The Court reaffirmed its holding in *National Bellas Hess* with a slight, but important, modification. It held that the interstate commerce clause did indeed bar North Dakota from imposing a use tax collection and payment

obligation on Quill. However, as a result of changes in its jurisprudence since its decision in *National Bellas Hess*, it concluded that there was no such due process impediment.

While this distinction would appear to interest academicians and scholars only, it is important because, while it cannot violate the Fourteenth Amendment, Congress can regulate interstate commerce. Thus, the Court reasoned that ‘‘Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes,’’ pursuant to its power to regulate commerce among the several states. [Quill, 504 U.S. at 318.] Although the Court was sympathetic to the plight of the states that are faced with an erosion of their sales and use tax base, it was even more sympathetic to the argument that businesses had reasonably relied on *National Bellas Hess* for 25 years.

Predictably, Congress has not taken any action to permit states to require remote sellers to collect their use taxes. As a result, it has fallen to the Supreme Court to impose that requirement as soon as the opportunity presents itself. In that regard, Alabama and South Dakota have taken important first steps in that process by amending their state sales tax laws to require out-of-state vendors without physical presence to collect their use tax in direct violation of *Quill*. Alabama adopted a new sales tax regulation that requires large out-of-state sellers to collect and remit its state sales and use tax effective as of January 1, 2016. For these purposes, a large retailer is defined as one with retail sales over $250,000 per year. [*See* Ala. Rule 810-6-2-.90.03; Ala. Code §40-23-68 (2016).] Likewise, South Dakota enacted a law that requires out-of-state retailers with “economic presence” in the state, *i.e.*, those with retail sales of at least $100,000 or with at least 200 transactions annually with South Dakota residents, to collect and remit sales and use taxes effective May 1, 2016.

The newly enacted sales tax laws of Alabama and South Dakota are clearly unconstitutional under *Quill*, and both states know this fact. Their goal was to commence the litigation process that could get one or more cases before the Supreme Court. Neither state expected to have its new statute or regulations or upheld by any lower court as a result of *Quill*, but the states were willing to lose at every turn before either case is eligible to be heard by the U.S. Supreme Court. The strategy of the states has finally paid off because on January 12, 2018 the Supreme Court agreed to hear *South Dakota v. Wayfair, Inc.*, a case challenging the constitutionality of South Dakota’s newly enacted sales and use tax law. Now we shall see if the Supreme Court is willing to acknowledge the changed and ever-changing nature of retail sales.

Within a few months, the Supreme Court can decide once and for all if *Quill* is to remain good law, or the circumstances under which states may impose sales and use tax collection obligations on remote sellers. While the outcome of the *Wayfair* case is far from certain, it would appear the Supreme Court is prepared to modernize its state sales and use tax jurisprudence and do away with the outmoded physical presence requirement. As a result, remote sellers may soon find themselves treated the same way as brick and mortar retailers when it comes to collecting sales and use taxes.