Commentary Regarding South Dakota Quill Challenge

South Dakota passed a new law this spring which seeks to challenge the *Quill* precedent. SB 106, which went into effect May 1, requires remote sellers, without any physical presence in the state of South Dakota, to register and collect and remit the South Dakota tax if the remote seller's gross revenue of sales of tangible property, any products transferred electronically, or services delivered into South Dakota exceeds $100,000 per year, or the remote seller has 200 or more separate sales transactions in the state per year. The legislation's sponsor, Sen. Deb Peters, has told the press that the law, which has provisions directly contrary to *Quill v. North Dakota*, was designed at least in part to draw a legal challenge in the hope of overturning *Quill*. Decided in 1992, *Quill* reaffirmed the physical presence standard for collecting sales tax.

The law provides that once litigation has been filed, enforcement is stayed until the matter is finally adjudicated. And the law has provisions to expedite the matter through the courts. Lawsuits were filed, even before the effective date of the legislation, so now the matter is in the Courts.

While some observers believe the South Dakota statute is a direct violation of *Quill*, and is unconstitutional under the dormant commerce clause, I believe it is important to recognize that U.S. Supreme Court Justice Anthony Kennedy "invited" this challenge in his concurring opinion in Direct Marketing Assn. v Brohl, 135 S. Ct. 1124, 1134, March 3, 2015. Relevant quotes from Justice Kennedy's concurring opinion in the DMA decision:

> *"Almost half a century ago, this Court determined that, under its Commerce Clause jurisprudence, States cannot require a business to collect use taxes—which are the equivalent of sales taxes for out-of-state purchases—if the business does not have a physical presence in the State."*
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> *"Twenty-five years later, the Court relied on stare decisis to reaffirm the physical presence requirement and to reject attempts to require a mail-order business to collect and pay use taxes. Quill Corp. v. North Dakota, 504 U. S. 298, 311 (1992). This was despite the fact that under the more recent and refined test elaborated in Complete Auto Transit, Inc. v. Brady, 430 U. S. 274 (1977), "contemporary Commerce Clause jurisprudence might not dictate the same result" as the Court had reached in Bellas Hess. Quill Corp., 504 U. S., at 311. In other words, the Quill majority acknowledged the prospect that its conclusion was wrong when the case was decided. Still, the Court determined vendors who had no physical presence in a State did not have the "substantial nexus with the taxing state" necessary to impose tax-collection duties under the Commerce Clause." "In Quill, the Court should have taken the opportunity to reevaluate Bellas Hess not only in light of Complete Auto but also in view of the dramatic technological and social changes that had taken place in our increasingly interconnected economy. There is a powerful case to be made that a retailer doing extensive business within a State has a sufficiently "substantial nexus" to justify imposing some minor tax-collection duty, even if that business is done through mail or the Internet."*
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> *"This argument has grown stronger, and the cause more urgent, with time. When the Court decided Quill, mail-order sales in the United States totaled $180 billion. But in 1992, the Internet was in its infancy. By 2008, e-commerce sales alone totaled $3.16 trillion per year in the United States."*

"Because of Quill and Bellas Hess, States have been unable to collect many of the taxes due on these purchases. California, for example, has estimated that it is able to collect only about 4% of the use taxes due on sales from out-of-state vendors." "States' education systems, healthcare services, and infrastructure are weakened as a result."

"The Internet has caused far-reaching systemic and structural changes in the economy, and, indeed, in many other societal dimensions. Although online businesses may not have a physical presence in some States, the Web has, in many ways, brought the average American closer to most major retailers. A connection to a shopper's favorite store is a click away—regardless of how close or far the nearest storefront. Today buyers have almost instant access to most retailers via cell phones, tablets, and laptops. As a result, a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term."

"Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court's holding in Quill. A case questionable even when decided, Quill now harms States to a degree far greater than could have been anticipated earlier. The instant case does not raise this issue in a manner appropriate for the Court to address it. It does provide, however, the means to note the importance of reconsidering doubtful authority. The legal system should find an appropriate case for this Court to reexamine Quill and Bellas Hess."

Based on Justice Kennedy's remarks, it should come as no surprise that the states have a renewed and strengthened interest in challenging *Quill* and gaining the authority to impose tax collection responsibilities on remote sellers. Even with provisions expediting the legal challenges to the South Dakota law, it may take several years before the matter is fully adjudicated. In the meantime, practitioners and remote sellers should be on the watch for other states to closely examine the activities of unregistered sellers, and expect more - and more aggressive - nexus challenges.

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if a powerful showing can be made that its rationale is still correct.

On March 3, 2015, the Supreme Court released its opinion in *Direct Mktg. Ass'n v. Brohl*, 135 S Ct 1124, 83 USLW 4133, 15 CDOS 2168, 2015 Daily Journal DAR 2473, 25 FLW Fed S 105, 2015 WL 867663 (hereafter, *DMA*). Few U.S. Supreme Court cases, let alone those decided unanimously (as *DMA* was), become known for a concurring opinion, written by a single justice, on an issue not presented to the Court.[1] But the *DMA* case may be an exception. While the case presented the Supreme Court with only a procedural question, Justice Kennedy filed a solo concurrence suggesting it was time to overturn a long-standing precedent, critical to the collection of state sales and use taxes, left over from the days of catalogue order forms and wall-mounted telephones. In fact, his concurring opinion went even further, inviting the states to bring a case challenging that precedent.[2]

new sales tax nexus law has triggered two lawsuits, but the litigation isn't preventing the state from enforcing the law's provisions.

As of May 9, 69 vendors meeting one or both of the criteria under SB 106 had complied with the law's requirements to register to collect and remit sales tax, according to Jonathan Harms, spokesman for the state Department of Revenue.

Harms said that despite the pending suits, the DOR will continue to carry out the law, but that sellers will have options during litigation.

"As the law continues in South Dakota, if a remote seller registers for a sales tax license and collects sales tax due in South Dakota but chooses not to remit the tax, then they would need to refund that collected tax to their customer," Harms said.

Harms added, "Of course, we continue to work and communicate with remote sellers in order to make sure there is understanding and compliance."

SB 106's sponsor is Sen. Deb Peters (R), a former president of the Streamlined Sales Tax Governing Board. On April 29 she told Tax Analysts that the law, which has provisions directly contrary to *Quill v. North Dakota*, was designed at least in part to draw a legal challenge in the hope of overturning *Quill*. Decided in 1992, *Quill* reaffirmed the physical presence standard for collecting sales tax.

It did draw a lawsuit, but the state took matters into its own hands as well. On April 28 the state filed for a declaratory judgment, naming four large retailers -- Wayfair Inc., Systemax Inc., Overstock.com Inc., and Newegg Inc. -- as defendants. The complaint said that the state "seeks a determination that it may require Defendants to collect and remit state sales tax on sales of tangible personal property and services for delivery into South Dakota."

On the same day, groups representing online and catalog retailers filed for a declaratory judgment as well, naming the DOR as defendant. That complaint said that as a direct violation of *Quill*, SB 106 is unconstitutional under the commerce clause.

Christopher Lutz of Horwood Marcus & Berk Chtd. said now that the state has filed its suit and named defendants, other retailers are less concerned about being named. He said that for many, it is simply easier to register and comply while they wait to see how the lawsuits resolve.

"For a lot of taxpayers, this is not the hill they want to die on," Lutz said.

I thought Lutz' comment (highlighted) in the article was interesting... my understanding is that once the lawsuit was filed, further enforcement of the registration and remittance requirements by the Department is stayed pending a final court decision. If the Department is not able to retroactively enforce the legislation, and can only enforce it prospectively once the matter is finally adjudicated, I don't see why a true "remote retailer" with no presence in South Dakota would "register and comply" now. The "easier" doesn't sit with me. So I went back and checked what Senate Bill 106 states with regards to the retroactive/prospective issue. It states, "If an injunction provided by this Act is lifted or dissolved, in general or with respect to a specific taxpayer, the state shall assess and apply the obligation established in section 1 of this Act from that date forward with respect to any taxpayer covered by the injunction." So if the injunction is against the SD DOR from applying the statute to any remote seller without a physical presence in the state, and if the Court overturns Quill allowing SB 106 to prevail, Bass Pro's on-line sales entity should only have a prospective liability from the date the injunction is lifted or dissolved.