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US Supreme Court Overturns Physical Presence Requirement in Sales Tax Case

June 25, 2018

The US Supreme Court handed down its decision in the closely watched case of *South Dakota v. Wayfair, Inc.* The case involved South Dakota's challenge to the longstanding rule that a seller must have a physical presence (*e.g.*, property or employees) in a state before it can be required to collect sales tax from buyers in the state. South Dakota prevailed, with the Supreme Court rejecting the physical presence requirement in a 5–4 decision.

The Supreme Court had established the physical presence rule more than 50 years ago in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967), and then affirmed the bright-line rule in 1992 in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). South Dakota challenged that rule by passing a statute that imposes an obligation to collect sales tax on any seller who, on an annual basis, has either $100,000 of sales or 200 transactions in the state. The South Dakota statute is grounded in the principle that when a seller has a certain level of economic activity in a state, the Constitution should permit that state to impose an obligation to collect sales tax. The Supreme Court agreed, concluding that the physical presence requirement should be set aside. The Supreme Court remanded the case back to the South Dakota Supreme Court to review issues that had not been briefed or considered previously. Now that the focus of the case has shifted from the physical presence requirement, it is possible the taxpayers will raise other constitutional concerns that the courts must consider.

In the meantime, attention will now turn to Congress and the states. Members of Congress had proposed several federal solutions. With the recent decision, Congress may be more inclined to pass legislation that addresses the perceived problems. As to the states, although some already have statutes similar to the South Dakota statute, many do not. Some states may make statutory changes to align their statutes with South Dakota's, but others may rely on statutes that do not offer the same level of constitutional protections that were approved by the Supreme Court in *Wayfair*.

The change from physical presence to economic activity as the guiding principle for determining nexus requires sellers to reevaluate their sales tax obligations and closely monitor developments in the upcoming months. If you have questions about the effect of the *Wayfair* decision, please reach out to a member of your Cooley tax team.

The Cooley tax team will also be hosting a webinar discussing the *Wayfair* decision and its impact on Thursday, June 28. Please be on the lookout for the invitation very soon.

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