

## Blog Post

# Risky Business? – South Dakota v. Wayfair, Inc. Sets Stage for SCOTUS Review of Physical Presence Requirement for Sales and Use Taxes

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It has long been the law of the land that a taxpayer must have a discernable physical presence in a state before it can be required to collect and remit sales and use taxes. The U.S. Supreme Court reaffirmed this bright-line test in the 1992 case of *Quill Corp. v. North Dakota*. In *Quill*, the Court held that interstate commerce would be unduly burdened if an out-of-state business were required to comply with the sales and use tax laws of thousands of state and local tax jurisdictions. Requiring a physical presence, the Court reasoned, is a constitutionally sufficient contact – or nexus – with a state or locality to impose sales and use tax collection duties.

Despite the clear precedent in *Quill*, many state legislatures have questioned its shelf life in our current online economy. When *Quill* was decided, the internet was merely a concept. Out-of-state businesses not otherwise having a physical presence in a state would seek customers through mail advertisements and catalogs. Business transactions were handled remotely by mail order. Such was the case of the taxpayer in *Quill*. Now, state legislatures argue, advancements in e-commerce obviate any need for a physical presence in a state or locality. As more and more businesses conduct business solely

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online, the sales tax revenues of many states has markedly decreased.

State legislators received a lifeline in 2015 when Justice Kennedy questioned the vitality of *Quill* in his concurring opinion in the *Direct Marketing Association* case. Less than a year later, the South Dakota legislature introduced and passed Senate Bill 106 requiring all out-of-state sellers to collect and remit sales tax on sales to South Dakota customers irrespective of any physical presence in the state. The findings of the South Dakota legislature acknowledged that the law was unconstitutional, but relied on Justice Kennedy's invitation to challenge the bright-line test in *Quill*. The law provided a fast track judicial process in order to ultimately present the issue to the U.S. Supreme Court.

South Dakota sued Wayfair, Inc. and several other online retailers immediately after enactment of the new law. In March 2017, the state trial court ruled in favor of the online retailers citing binding precedent in *Quill*. In its appeal to the Supreme Court of South Dakota, the state requested that the court expeditiously affirm the holding of the lower court to allow a quick appeal to the U.S. Supreme Court. The state got its wish when the state court issued its decision a mere 15 days after oral argument. This sets the stage for the showdown that South Dakota has so desperately sought. However, the litigation strategy employed by South Dakota in *Wayfair* is unquestionably high risk.

In its haste to "tee up" the case for the U.S. Supreme Court, South Dakota permitted very little factual development in *Wayfair*. Further, the state offered no resistance before the trial court or the Supreme Court of South Dakota. Instead of presenting a contrasting doctrinal case for victory – which could take time – the state took the bold step of asking each court to strike down the law based on the holding in *Quill*. If the U.S. Supreme Court does not take the appeal, South Dakota is bound by the taxpayer-favorable ruling of its highest court. Perhaps more

impactful, the aggressiveness of state legislatures seeking to challenge *Quill* may be assuaged if the U.S. Supreme Court denies review. Risky business indeed...

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