



Taxing Decision

With *Wayfair* Case, States Eye Internet Tax Pot of Gold

Featured Story

February 20, 2018

By [Michael J. Bowen](#)

For years, state officials have wrung their hands in frustration because they haven't been able to tax most online retail sales. By some estimates, states could collect an extra \$211 billion over the next five years in sales taxes from burgeoning online revenue, and they hope that the U.S. Supreme Court will give them the green light this spring to dip into this mostly untapped pool to fill state treasuries.

At issue is a 1992 Supreme Court ruling, *Quill Corp. v. North Dakota*, prompted by the state's efforts to collect sales tax from an Illinois catalog company. The court sided with the catalog company in straightforward terms: A company must have a physical presence in a state to be subject to sales tax. That's been the law of the land ever since, but states argue that the court could not have foreseen the

Related People

[Michael J. Bowen](#)

Related Work

[Digital Goods and Emerging Technologies Taxation](#)

[State and Local Tax Consulting and Controversy Tax](#)

Another Featured Story

[Road Rules: Lawmakers Slowly Begin to](#)

consequences of this ruling in 2018 when consumers are buying billions of dollars of goods with a few keyboard clicks rather than going to the mall.

Regulate the
Gig Economy



\$211 Billion

Estimated additional tax revenue states could collect from online sales over the next five years

The states hope to relegate *Quill* to the dustbin of court precedents, but they know that it requires a compelling argument to persuade the court to withdraw its deference to past decisions, the concept of *stare decisis*. The South Dakota Legislature set the table in 2016 when it passed a bill levying a sales tax on all out-of-state companies that sell more than \$100,000 annually to state residents or have more than 200 transactions, knowing that it would be struck down by the lower courts. The Supreme Court obligingly agreed in January to review the resulting case against a Massachusetts online home furnishings company that refused to pay South Dakota's new tax. *South Dakota v. Wayfair* is now before the high court, and states have the showdown they wanted.

The court's decision will pivot on its modern view of the Commerce Clause, which gives to Congress the right to "regulate *commerce* with foreign nations, and among the several states. ..." Libraries are filled with court opinions and scholarly articles interpreting that sparse sentence, which grew from the Continental Congress' frustration over states'

enthusiasm for creatively taxing everything that moved across their borders, in order to protect their own businesses. With the Commerce Clause, Congress told the states it would have ultimate authority over everything, taxes included, that might thwart interstate commerce and the development of a robust national economy.

” With *Wayfair* before the high court, states have the showdown they wanted.

Impatient with Congress, the states have gone to the courts

Today’s Congress has been reluctant so far to exercise that power to set the rules for online retail taxes. Lawmakers have danced around three pieces of legislation since 2012 that address the issue but have been unable to move anything through both chambers. On this issue, the divide isn’t partisan, but pits one class of businesses’ interests against another. Like a lot of issues that prove too hot for legislators, this one has ended up in the courts.

The stakes are high. Revenue-starved states see a fix for lean budgets in an era when they are loath to raise income taxes. Shopping centers and local businesses hope to roll back at least part of the price incentive for buying online. On the other side, e-commerce businesses fear they will have to calculate sales taxes for thousands of state, local and special taxing districts, and they are particularly worried that states will try to collect these taxes for years past. At least one state already has indicated its intent to retroactively collect online sales taxes for three years if the Supreme Court allows it.

Interestingly, Amazon, the company that started the online sales revolution, isn't part of this lawsuit. Along with 18 of the top 20 companies in online sales, Amazon already pays state sales taxes. With Amazon's success has come the necessity of a physical presence in the form of distribution centers in most states, and other big online sellers have local brick-and-mortar stores. For the largest retailers, avoiding state sales taxes hasn't been an option.

States Argue: We Need the Money

South Dakota's lawsuit relies heavily on the proposition that the court should overturn precedent because the physical presence rule didn't contemplate the efficiency of modern, digital commerce and the devastating effect that losing a source of tax revenue has on governments' ability to provide schools, roads and other services. Among their arguments for striking down *Quill*:

- **State treasuries are hurting.** Local and state governments are "severely and increasingly hurt" by their inability to collect internet sales taxes, South Dakota argued in its petition for cert. Thirty-three states faced revenue shortfalls in 2017, according to the brief, and while the two sides dispute the actual amount of lost revenue, there is no doubt that state governments could use the money. As the states see it, they are being deprived of revenue that is rightfully theirs.
- **Tax-free internet purchases are not fair to local businesses.** The "subsidy" that internet companies benefit from by not paying state sales taxes tilts the playing field against smaller and local retailers, making business less competitive and draining local economies, the states contend. In one of the 21 *amici* briefs filed in the case, the American Booksellers Association says online retail poses an "existential threat to independent bookstores."
- ***Quill* was never a soundly reasoned decision.** An *amici* brief signed by 35 states calls *Quill's*

physical presence rule an affront to their sovereignty and urges the justices to give it “the complete burial it justly deserves.” Rather than protect the flow of interstate commerce – the purpose of the Commerce Clause – the law’s requirement for a physical presence to collect sales tax discourages businesses from investing in infrastructure in all but a few states, the plaintiffs say. Rather than remove barriers to interstate commerce, *Quill* has the perverse result of discouraging businesses from investing in physical facilities such as stores or warehouses outside of their home states.

” Many believe it’s inevitable that the states eventually will collect internet sales taxes.

Online Retailers Argue: Let Congress do its Job

Supporters of the status quo say plaintiffs are playing fast and loose with their underlying assumptions about consumer behavior, and they also believe that *Wayfair* has fatal procedural legal flaws created by the fast track the state carved out to get it to the court quickly. Among their arguments against upending *Quill*:

- **This is a job for Congress.** Three bills are circulating in Congress that would set parameters for the states to collect online sales taxes. While many believe it’s inevitable that the states eventually will collect internet sales taxes, Congress is moving deliberately to avoid legislation that is burdensome to all concerned. If states need a bigger share of online sales, it

should be up to Congress to craft that relief carefully – not the courts.

- **Online sales are not what ails brick-and-mortar retail.** Proponents of the internet sales tax cite the “showrooming” effect in which consumers examine goods in a store and then go home and buy them cheaper online. But there also is the “webrooming” effect, in which consumers research goods online and then visit stores to make the purchase. And if many shopping centers and local retailers are struggling, it may have more to do with poor customer service and the inevitable change in shopping habits that always have pushed retail to evolve. Regardless, it’s not the court’s job to step in and save Main Street retail from ills brought on by technology and changing consumer preferences. Oh, and about those bookstores: The booksellers’ own brief says there has been a 35 percent increase in independent bookstore locations since 2009.
- ***Stare decisis* sets the bar high.** The court takes precedent seriously and generally only sets aside prior decisions when there is compelling evidence that the decision was wrong – either in its legal reasoning or because the underlying issue has fundamentally changed.

Win or Lose, the Taxman is Coming

Several justices noted previously the imbalances created by *Quill*, and that suggests the court may be of a mind to turn away from it. On the other hand, this case asks the court to legislate a fundamental change to our tax system, and the justices may be reluctant to go there, especially with Congress signaling its intent to plod toward a compromise solution eventually.

Whichever way the court goes, it is safe to say that the days of tax-free internet sales are numbered. The question is whether Congress will step in and write the rules for this new tax regime or if the Supreme

Court will strike the first blow.

Michael J. Bowen chairs Akerman's State and Local Tax Practice in the firm's Jacksonville office. His national team advises multistate clients on compliance, controversy and litigation matters in all 50 states. He can be contacted at michael.bowen@akerman.com or 904.598.8625.

This information is intended to inform clients and friends about legal developments, including recent decisions of various courts and administrative bodies. This should not be construed as legal advice or a legal opinion, and readers should not act upon the information contained in this email without seeking the advice of legal counsel.