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Nexus in a Post-Wayfair World

Legal Update

06.22.2018

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A merchant of goods and services that makes sales in multiple states is no longer required to have physical presence in a state in order to be subject to sales and use tax in that state. In a 5–4 ruling issued on June 21, 2018 (*South Dakota v. Wayfair*), the U.S. Supreme Court rejected its 50-year-old bright-line physical presence rule, calling it “unfair and unjust” to brick-and-mortar stores and an improper judicially-created limit on the “states’ ability to seek long-term prosperity.”

All nine justices agreed that the physical presence rule is problematic. But the four dissenting justices argued that because sellers of goods and services have been relying on the rule for more than 50 years, the Court should not overturn it. The majority, however, determined that states’ recent creativity in interpreting the Court’s physical presence rule has undermined the rule’s bright-line and will likely lead to disputes about what physical presence means. Specifically, the Court referred to Massachusetts’ newly-enacted “cookie nexus,” which defines physical presence to include making apps available for download by in-state residents and placing cookies on their web browsers. Accordingly, the majority was not troubled by overturning its prior rulings in *National Bellas Hess* (1967) and *Quill* (1992).

After going to great lengths to demonstrate why it dislikes the physical presence rule, the Court found comfort in South Dakota’s economic nexus provision. South Dakota’s law provides that if a seller delivers more than \$100,000 worth of goods or services into South Dakota or has more than 200 transactions for delivery of goods or services into the state, it must collect and remit sales and use tax in the state. The Court found that these thresholds are constitutional because they offer small merchants a “reasonable degree of protection” and because South Dakota’s provision is not retroactive. The Court noted that there may be other situations not before the Court where there might be an undue burden on interstate commerce but provided no guidance about what such situations might be.

What Next?

Most states will take some time to evaluate how they will react to the U.S. Supreme Court’s decision in *Wayfair*. Minnesota, for example, announced that it is pleased with the opinion and that it “will work with [its] customers to ensure fair, efficient, and

transparent implementation of this decision." Minnesota promises to provide further guidance within 30 days.

Given the *Wayfair* decision, the following is recommended for businesses:

- **Evaluate existing state statutes.** Many states anticipated that the Court would overrule the physical presence requirement. These states enacted economic nexus provisions or provisions that allow taxation "to the limit allowed by the U.S. Constitution." Other states enacted expanded nexus requirements using laws that became effective on June 21, 2018, the date the physical requirement was overturned. Evaluate whether such provisions became constitutional under *Wayfair*. Determine how and when to comply.
- **Analyze where you make sales.** In states where sales exceed published thresholds, consider registering to begin collecting and remitting sales and use tax. Consider the potential problem of exceeding thresholds halfway through the year. Thus, alternatively, consider registering and collecting sales and use tax in all states where you make sales.
- **Think retroactively.** The U.S. Supreme Court did not meaningfully address whether states can impose economic nexus provisions retroactively. Evaluate whether other provisions in state statutes prohibit retroactivity. Evaluate whether purchasers may have already paid use tax (might be hard to prove). Consider voluntary disclosures.
- **Consider defenses other than physical presence.** In each state, carefully analyze taxability and sourcing. Evaluate Due Process Clause nexus defenses (seller must purposefully avail itself of the market).
- **Get documentation in order.** Obtain exemption certificates in all states where you have transactions. Ensure that sales tax is separately stated on all invoices. Revise contracts to provide that the seller will collect sales tax from the buyer and will remit the tax. If you are a seller, do not continue relying on buyers to file use tax returns. Implement procedures to track sales.
- **Monitor future legislation.** Some states will jump on enacting economic nexus provisions. Some states might try to push the thresholds to \$50,000 or perhaps 100 transactions or even lower (one transaction?). Careful compliance decisions will need to be made in those states. Federal legislation is possible but not likely in the near future.
- **Consider impact on other tax types, including income tax and gross receipts taxes.** Many taxpayers have been relying on the physical presence rule in other tax contexts. Consider voluntary disclosures in the income tax and gross receipts tax context.

Contact Fredrikson & Byron's Masha Yevzelman with any questions you encounter as you engage in the above analysis and evaluation.