taxnotes® state
Volume 96, Number 3 ■ April 20, 2020

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Reprinted from *Tax Notes State*, April 20, 2020, p. 381

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In this article, Hebert discusses state and local tax jurisprudence before *South Dakota v. Wayfair*, the effects of *Wayfair* on economic actors and states, and recommendations regarding post-*Wayfair* state legislation.

Introduction

State and local tax jurisprudence changed greatly in 2018. In *South Dakota v. Wayfair*,[1] the U.S. Supreme Court dispensed with a rule that prevented states from requiring out-of-state sellers to collect and remit sales tax on sales made to purchasers located within the taxing state.[2] However, jurisprudence centered on the dormant commerce clause evolved over decades before *Wayfair* was decided, settling on the so-called physical presence rule.[3] Before *Wayfair* was decided, states did not have the jurisdiction to levy sales taxes on sales made by out-of-state sellers.[4] Jurisprudence pre-*Wayfair* allowed for any sales made by out-of-state sellers to escape sales tax collection and remittance, even though sales made by sellers located within the taxing state would be subject to sales tax.[5] The Supreme Court reaffirmed this pre-*Wayfair* paradigm in *Quill Corp. v. North Dakota*.[6] In the years following *Quill*, states attempted to circumvent this decision by enacting legislation to liberalize the standard for sellers to establish a physical presence within a state for purposes of the dormant commerce clause.[7] Ultimately, the Supreme Court was faced with the dilemma of adhering to precedent and the established constitutional standards that went with them, while trying to apply these standards to a rapidly changing technological landscape that was affecting the way that retailers conducted business. *Wayfair* illustrated the various interests that are affected by new sales tax legislation: states' need to preserve revenue amid rising costs to operate state services, the needs of businesses to maintain low compliance costs, especially those businesses selling products to purchasers in multiple states, and in-state businesses that posited that they were put at a competitive disadvantage by the paradigm established under *Quill* and its predecessors. Following *Wayfair*, states jumped at the opportunity to levy sales taxes on sales made in state by out-of-state sellers. Legislating the levying of sales taxes on out-of-state transactions presents challenges that are highlighted by *Wayfair* and emphasized by the needs of the marketplace. When enacting sales taxes on out-of-state transactions, states must comply with the safe harbors established in *Wayfair*. Also, states should draft new sales tax legislation with the goal of making compliance with sales tax collection both simplified and relatively inexpensive when compared with the compliance burdens borne by in-state sellers.

The implications of *Wayfair* have yet to be fully realized by states, out-of-state businesses, or their customers. The opinion in *Wayfair* affects out-of-state online businesses most immediately in the sales and use tax arena. But based on the Supreme

[1] 585 U.S. ___, 138 S. Ct. 2080 (2018).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] 504 U.S. 298 (1992).

[7] *Direct Marketing Association v. Brohl*, 575 U.S. ___ (2015).

Court's expansive view of states' jurisdiction to tax out-of-state sellers in light of the dormant commerce clause, it logically follows that states will have the jurisdiction to levy additional taxes on transactions made between out-of-state sellers and in-state purchasers. In particular, states that choose to tax the income earned by out-of-state sellers will not be found to have run afoul the dormant commerce clause.

The Evolution of Dormant Commerce Clause, Jurisdictional, and Due Process Jurisprudence

For the second half of the 20th century, due process and commerce clause jurisprudence evolved hand in hand. Cases implicating both due process and commerce clause matters often involved an out-of-state business and a state seeking to exert jurisdiction over that business. Before the 21st century, a central theme underlying these decisions was that states were constrained in their abilities to exert jurisdiction over out-of-state businesses, be they out-of-state sellers shipping goods to in-state purchasers or merely franchisees having contact with a franchiser located in a different state.[8] Many of the following cases involving out-of-state sellers reflect the overlap of commerce clause limitations, jurisdictional limitations, and due process. The due process clause and commerce clause address "different constitutional concerns."[9] Although the commerce clause and due process requirements are "closely related," they impose different limits upon a state's authority to tax out-of-state sellers.[10] Thus, a state may be able to impose a tax that is consistent with the due process clause, but the tax may violate the commerce clause and consequently be invalid.[11] Even though the two clauses are often implicated in the same cases, the Supreme Court has recognized that each clause requires its own distinct analysis and encourages that to promote clarity of decision-making by the Court.[12]

[8] *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985).

[9] *Id.*

[10] *Quill*, 504 U.S. at 305.

[11] *Id.*

[12] *Id.*

The Due Process Clause and Interstate Commerce

The due process clause of the U.S. Constitution "requires some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax."[13] Further, the "income attributed to the state for tax purposes must be rationally related to values connected with the taxing state."[14] *National Bellas Hess v. Department of Revenue* laid the groundwork for what would become the Supreme Court's standard until 1992 for determining if a state's tax on an out-of-state seller satisfied both the commerce and due process clauses.[15]

National Bellas Hess centered on an action by the appellant to recover taxes assessed under the Illinois Use Tax Act.[16] Illinois state statute required out-of-state sellers to collect and remit to the state use taxes imposed upon in-state purchasers who purchase a company's goods for use within Illinois.[17] National Bellas Hess Inc. was a mail-order business incorporated in the state of Delaware and licensed to do business in only Delaware and Missouri.[18] The appellant did not maintain an office in the state of Illinois, nor did it employ sales representatives within that state.[19] Even though the appellant maintained no physical presence in Illinois, the Department of Revenue secured a judgment from the Illinois Supreme Court ordering the appellant to pay to the state use taxes.[20]

In his discussion of the due process clause of the 14th Amendment, Justice Potter Stewart, writing for the majority, wrote that in determining whether a state tax satisfies the requirements of the clause, the Court must examine whether the taxing state has given out "anything for which it can ask return."[21] Stewart then related that

[13] *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345 (1954).

[14] *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 273 (1978).

[15] *Quill*, 504 U.S. at 309.

[16] *National Bellas Hess Inc. v. Department of Revenue of Illinois*, 386 U.S. 753, 754 (1967).

[17] *Id.* at 755.

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.* at 756, citing *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

principle to a state's power to impose a use tax upon interstate sales.[22] Invoking *Miller*, Stewart wrote that for a use tax, similar to a sales tax levied on an interstate sale, there must be "some definite link, some minimum connection," between the taxpayer and the taxing state.[23] In exchange for its connection to the taxing state, the taxpayer receives the "protection and services of the taxing state," for which the state can justify levying a tax.[24]

Citing *Felt and Tarrant Manufacturing Co. v. Gallagher*, Stewart distinguished *National Bellas Hess* from cases in which the Court has upheld a tax on interstate sales.[25] In *Felt*, the Supreme Court upheld a state's requirement that an out-of-state seller collect a local use tax.[26] The Court reasoned that the sales at issue were made by local agents sent to the state by the out-of-state seller and, thus, the seller had established the necessary minimum connection with the taxing state to justify upholding the tax.[27] Stewart distinguished *Felt* from the Illinois tax at issue, reasoning that National Bellas Hess's only connection with its Illinois customers was by common carrier, while the taxpayer in *Felt* established a physical presence within the taxing state and thus availed itself of the state's protection and services, which the state could tax in return.[28]

Most importantly, Stewart drew a stark line between businesses that physically operate within a state and businesses that cater to their customers by common carrier only.[29] This distinction served to reaffirm the Court's standard to evaluate whether a state exceeded its taxation authority under the due process clause. Stewart wrote:

> In order to uphold the power of Illinois to impose use tax burdens on National [Bellas Hess] in this case, we would have to repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers and retail outlets, solicitors, or property within a state, and those who do no more than communicate with customers in the state by mail or common carrier as part of a general interstate business.[30]

National Bellas Hess reaffirmed the rule that a state cannot impose a tax, most commonly a sales or use tax, upon an out-of-state seller unless the seller has established a physical presence in the taxing state.[31] Even though the Supreme Court adopted a broad definition of physical presence in relation to the due process clause of the 14th Amendment, this definition did not encompass businesses that have no physical presence and deliver goods to their customers only by mail or common carrier.[32] *National Bellas Hess* effectively created a safe harbor for out-of-state businesses to contract with in-state purchasers while escaping that state's tax jurisdiction.[33] From 1967 until 1992, the due process standard of *National Bellas Hess* was the governing law for the states' tax jurisdiction of interstate commerce.[34]

In 1985 the Supreme Court revisited the question whether an individual must maintain a physical presence within a state before that state can attain jurisdiction over that person for due process purposes.[35] In *Burger King Corp. v. Rudzewicz*, the appellees entered into a franchise agreement with Burger King Corp., a Florida corporation headquartered in Miami.[36] Three years into the term of the franchise agreement between the appellant and appellee, appellant Burger King terminated the franchise agreement; however, the appellee-franchisees continued to occupy and operate the franchise restaurant.[37] Thereafter, appellant Burger King sued the appellees in federal court, alleging breach of contract and tortious use of the Burger King

[22] *Id.* at 756.
[23] *Id.* at 756, citing *Miller* at 344.
[24] *Id.* at 757.
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.*
[29] *Id.* at 758.
[30] *Id.*
[31] *Id.* at 758-759.
[32] *Id.* at 759.
[33] *Id.*
[34] *Quill*, 504 U.S. at 298.
[35] *Burger King*, 471 U.S. at 462.
[36] *Id.* at 464.
[37] *Id.* at 468.

trademarks.[38] At issue in this case was whether Florida could attain diversity jurisdiction over the appellees under Florida's long-arm statute.[39]

Florida's long-arm statute extends jurisdiction to "any person, whether or not a citizen or resident of this state," who "breaches a contract in this state by failing to perform acts required by the contract to be performed in this state," so long as the cause of action arises from the alleged contractual breach.[40] At the district court level, the court determined that jurisdiction in fact existed under the long-arm statute. However, this decision was overturned by the court of appeals. The Supreme Court held that Florida did have jurisdiction over the appellees. The Court reasoned that parties who reach out over state lines to enter into contractual agreements with parties of another state are "subject to regulation and sanctions" in the other state for the consequences of their actions.[41] Further, the Court held that a party will be deemed to have established minimum contacts with a state if the party "purposefully avails itself of the privilege of conducting activities within the forum state, thus invoking the benefits and protections of its laws."[42]

In this case, the appellees created "continuing obligations" between themselves and a resident of Florida (albeit a corporation, which the Court considered to be a state "resident" for purposes of establishing this continuing obligation), and therefore, they could reasonably expect to appear in a Florida court (state or federal) in the event of a dispute with the Florida resident.[43] The Court noted that an out-of-state party having this expectation is considered to have adequate notice for due process purposes.[44] So long as a commercial actor's efforts are "purposefully directed" toward residents of another state, the Court has consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.[45]

[38] *Id.* at 468-469.

[39] *Id.* at 469.

[40] *Id.* at 463-464.

[41] *Id.* at 473.

[42] *Id.* at 475.

[43] *Id.*

[44] *Id.* at 478-479.

[45] *Id.* at 476, citing *Keeton v. Hustler Magazine Inc.*, 465 U.S. 770, 774-775 (1984).

With *Burger King*, the Supreme Court began the trend of lowering the threshold for states to attain jurisdiction over out-of-state actors while staying within the confines of the due process clause. In *Wayfair*, the majority cited *Burger King* as a rationale to liberalize states' tax authority to an unprecedented level.[46]

Commerce Clause and Related Jurisdictional Jurisprudence Before *Wayfair*: The Journey Toward a Settled Constitutional Standard

Commerce clause jurisprudence, certainly as it relates to state taxation, was not established quickly. Rather, this line of jurisprudence arose out of more than a century of tinkering followed by a large-scale overhaul by the U.S. Supreme Court. The Court experimented over decades with different standards and tests to determine the validity of a state's tax that was challenged under the commerce clause, as well as cases that address the issue of states' jurisdiction to tax generally. Before *Wayfair*, in 1977 the Court arrived at its test to determine whether a tax on interstate commerce was valid. Further, a later case interpreting part of the test established in 1977 was decided in 1992, but only to be overruled by *Wayfair* in 2018.

Article I, section 8, clause 3 of the U.S. Constitution, commonly referred to as the commerce clause, grants to Congress the power to "regulate commerce with foreign nations, among the states, and with the Indian Tribes." The modern jurisprudence interpreting the commerce clause (and the dormant commerce clause, effectively) can be traced to the decision of *Gibbons v. Ogden*. In *Gibbons*, the petitioner and respondent were once partners in a steamboat operation.[47] Their partnership acrimoniously dissolved after three years when Gibbons, who operated steamboats in New York and New Jersey under a federal coastal license, operated another steamboat on a New York route owned by Ogden.[48] Suing in New York state court, Ogden asserted that New York had jurisdiction to enjoin Gibbons from operating the steamboat on

[46] *Wayfair*, 138 S. Ct at 2093.

[47] *Gibbons v. Ogden*, 22 U.S. 1 (1824).

[48] *Id.*

Ogden's route, and he prevailed.[49] Gibbons asserted that New York did not have jurisdiction to enter the injunction on the basis that Congress had the jurisdiction to regulate interstate commerce rather than New York state.[50] Gibbons appealed this matter to the U.S. Supreme Court.[51] The Supreme Court found for Gibbons, holding that the regulation of navigation of steamboat operators for the purpose of transacting interstate commerce was a power to be exercised by Congress under the commerce clause, and not the states.[52]

Gibbons provided the Supreme Court with the opportunity to opine on the definition of the term "commerce," as well as explore the limits on congressional authority to regulate it. The Court defined "commerce" as including "traffic . . . buying and selling, or the interchange of commodities," but did not limit it to encompassing only those activities.[53] The Court went further to define "commerce" as "intercourse . . . among the nations and parts of nations, in all its branches, and is regulated by prescribing rules for carrying on that intercourse."[54] The Court addressed the meaning of commerce "among the states," holding that the word "among" means "intermingled with."[55] Here, the Court noted that commerce "among the states" includes commerce leaving the boundaries of one state and then crossing the boundaries of another.[56]

Gibbons established that Congress has expansive authority to regulate transactions that cross state lines in order to be consummated. However, as Justice William Johnson wrote in his concurring opinion in *Gibbons*, the commerce clause is more than an affirmative grant of power to Congress; it constrains state activity as well.[57] The commerce clause, according to Justice Harlan F. Stone in *South Carolina State Highway Department v. Barnwell Brothers Inc.*, prohibits some state actions that interfere with interstate commerce.[58] The Supreme Court revisited the commerce clause several times thereafter, taking about 50 years of evolution to reach what one would consider to be settled doctrine.

The U.S. Supreme Court later addressed direct implications of the commerce clause in the context of state taxation. In *Leloup v. Port of Mobile*, the Supreme Court held that "no state has the right to lay a tax on interstate commerce in any form," and overturned a state tax on interstate commerce.[59] In *Sanford v. Poe*, the Court reviewed a state's tax that required all telegraph, telephone, and express companies doing business in Ohio to file annual tax returns in Ohio.[60] The Court narrowed its holding in *Leloup* by holding that since the tax on telegraph, telephone, and express companies was not a direct burden on interstate commerce, the state was permitted to impose the tax.[61] In *Northwestern States Portland Cement Co. v. Minnesota*, the Supreme Court held that the state of Minnesota could lawfully impose an income tax on an Iowa corporation that maintained an office within Minnesota.[62] In *Northwestern States*, the Court reasoned that since the taxes at issue were based solely upon the Iowa corporation's net profits that it earned within Minnesota, Minnesota had established a valid "constitutional channel" to "make interstate commerce pay its way."[63] This decision was controversial.

Northwestern States was decided in February 1959, and it led to a backlash among the business lobby and their representatives in Congress.[64] Within months after *Northwestern States* was decided, Congress enacted Public Law 86-272 in 1959.[65] P.L. 86-272 prohibits states from imposing taxes on, or measured by, net income derived

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[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] *Id.* at 189.

[54] *Id.* at 190.

[55] *Id.* at 194.

[56] *Id.*

[57] *Quill*, 504 U.S. at 309 (citing *Gibbons*).

[58] 303 U.S. 177, 185 (1938).

[59] 127 U.S. 640 (1888).

[60] 165 U.S. 194 (1895).

[61] *Id.*

[62] 358 U.S. 450 (1959).

[63] *Id.*

[64] *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 218 (1992).

[65] Walter Hellerstein et. al, *State and Local Taxation: Cases and Materials* 91, citing P.L. 86-272 (2014).

within the state from interstate commerce if the "only business activities carried on within the state" are the solicitation of orders for sales of tangible personal property, and the orders are then sent outside the state for approval and filled by a shipment from a location outside the state.[66] The first effect of P.L. 86-272 was to limit the states' authority to tax sales of tangible personal property, but it does not include airlines, railroads, pipelines, telecommunications, trucking, bus, or other companies involved in the transportation industry, as well as the broadcasting industry.[67] The second limitation established by P. L. 86-272, relating to the solicitation of orders, does not include sellers that collect even part of the purchase price from buyers when the seller is within the state.[68] This law effectively eliminated the option of out-of-state sellers maintaining a warehouse within the taxing state for the purpose of fulfilling orders, even if the orders are approved at a location outside the state.[69] According to the legislative history of the law, maintaining a sales office within the taxing state would expose that seller to in-state taxation.[70]

Later decisions upended the direct or indirect burden analysis in favor of the "multiple taxation doctrine," which focuses on whether a particular tax subjected interstate commerce to a risk of taxation in multiple states.[71] However, the Supreme Court in *Freeman v. Hewit* revived its use of the distinction between direct and indirect taxation by striking down a state's gross receipts tax on a transaction because applying such a tax would place a "direct tax on interstate commerce."[72] Then, the Supreme Court in *Complete Auto Transit Co. v. Brady* later overruled *Freeman*.[73]

In *Complete Auto*, the Court cited *Freeman* as "attaching constitutional significance to a semantic difference," and determined that the proper analysis of whether the imposition of a state's tax will satisfy a challenge under the commerce clause must be to look past "the formal language of the tax" and to examine the tax's "practical effect."[74] Citing an earlier case, *Railway Express Agency Inc. v. Virginia*, the Court noted the danger in which "magic words or labels" could "disable an otherwise constitutional levy [of tax]."[75] The Court in *Complete Auto* then jettisoned the distinction between direct and indirect taxes on interstate commerce on the basis that such tax levies survived or failed a challenge under the commerce clause on the basis of "legal terminology," "draftsmanship and phraseology."[76] In response to what this author considers to be the Court's yearning for a settled, workable standard, the Court in *Complete Auto* established a four-part test to evaluate whether a state's tax satisfies the commerce clause.[77] In *Complete Auto*, the Supreme Court held that it will sustain a state's tax against a challenge under the commerce clause if the "tax [1] is applied to an activity that has a substantial nexus with the taxing state, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the state."[78]

'Substantial Nexus': The Precursor to *Wayfair*

The first prong of the *Complete Auto* test, requiring that activities have a substantial nexus with the taxing state, has been the subject of much litigation and ultimately led to the line of cases ending with *Wayfair* in 2018. In 1987 *Tyler Pipe Industries v. Washington State Department of Revenue* was the first case in which the Supreme Court tested the outer limits of the substantial nexus requirement.[79] In *Tyler Pipe*, the Court held that independent contractors located within a particular state who were working for an out-of-

[66] *Id.*

[67] *Id.*

[68] *Id.* at 92.

[69] *Id.* at 92.

[70] *Id.* at 93.

[71] *Quill*, 504 U.S. at 309.

[72] 329 U.S. 249, 256 (1946).

[73] 430 U.S. 274, 285 (1977).

[74] *Id.* at 279.

[75] 358 U.S. 434, 441 (1959).

[76] *Complete Auto*, 430 U.S. at 281.

[77] *Id.* Out of concern for academic integrity, and as a matter of practice, the author does not editorialize or speculate on any court's unexpressed intentions underlying its ruling on any particular matter. However, in light of the Court's doctrinal overhaul in *Complete Auto*, together with its (repeated) expressed distaste for taxes that hinge on the skillfulness of their draftsmanship rather than their practical effect, the author admittedly feels comfortable taking such a liberty in this narrow instance.

[78] *Complete Auto*, 430 U.S. at 279.

[79] 483 U.S. 232 (1987).

state seller could establish the necessary nexus to allow that state to levy a tax on that seller.[80] Appellant Tyler Pipe Industries sought a refund of wholesale taxes it paid to the appellee over a four-year period for products sold to customers in Washington.[81] Tyler Pipe argued that it did not have a substantial nexus with the state of Washington to justify it taxing sales of its products to customers within the state.[82] Tyler Pipe maintained no office, owned no property, and employed nobody within the state of Washington.[83] Tyler Pipe solicited customers through its executives located out of state and through an independent contractor located within the state.[84]

The Supreme Court noted that "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales."[85] The Court held that Tyler Pipe's use of an independent contractor within the state of Washington was sufficient to establish a substantial nexus with the state because it used a local representative (the independent contractor) to cultivate and maintain its market, and to protect its interests.[86] The fact that Tyler Pipe used an independent contractor to work in Washington, rather than an employee, is a distinction that is "without constitutional significance."[87] Although the Court began to liberalize the nexus standard for commerce clause analyses, it maintained the due process physical presence standard for several years to come.

Quill Corp. v. North Dakota: The Pre-*Wayfair* Nexus Standard

In 1992 *Quill* provided the Supreme Court with the opportunity to reevaluate both the nexus standard under the commerce clause and the physical presence standard that was reaffirmed in 1967 in *National Bellas Hess*. Quill, the appellant, was a Delaware corporation with offices in Illinois, California, and Georgia.[88] Quill sold office equipment and supplies, had no employees in the state of North Dakota, nor did it own or maintain any property in the state.[89] Quill solicited its customers in North Dakota with flyers, catalogs, and telephone calls.[90] Quill delivered all orders to customers by common carrier or U.S. mail from points out of state.[91] Quill did not collect sales or use tax on sales made to its customers in North Dakota until 1987, when North Dakota amended its law to require tax collection from all persons that engage "in regular or systematic solicitation of a consumer market in th[e] state."[92] The state's regulations defined "regular or systematic solicitation" as publishing "three or more advertisements in a 12-month period."[93] This amendment to North Dakota's law effectively included mail-order companies that maintained no physical presence in North Dakota among the "retailers" that had been traditionally required to collect sales or use taxes on products sold.[94]

Appellant Quill asserted that North Dakota did not have constitutional authority to compel it to collect and remit use taxes to the state.[95] The trial court found for Quill, reasoning that under *Bellas Hess*, North Dakota had not shown that Quill had availed itself of North Dakota's services and protection and thus no nexus between Quill and the state had been established.[96] The North Dakota Supreme Court reversed, reasoning that changes in the economy and law rendered *Bellas Hess* "inappropriate to follow."[97] The court cited the recent growth in the mail-order business and how technology had made tax compliance easier

[80] *Id.* at 251-252.
[81] *Id.* at 249.
[82] *Id.*
[83] *Id.*
[84] *Id.* at 250.
[85] *Id.*
[86] *Id.* at 251.
[87] *Id.* at 250.

[88] *Quill*, 504 U.S. at 302.
[89] *Id.*
[90] *Id.*
[91] *Id.*
[92] *Id.* at 302-303.
[93] *Id.*, citing N.D. Admin. Code section 81-04.1-01-03.1.
[94] *Id.* at 303.
[95] *Id.*
[96] *Id.*
[97] *Id.*

for businesses.[98] Regarding the due process clause, the court reasoned that recent cases following *Bellas Hess* established that physical presence was not necessary to establish minimum contacts with a particular state before that state could exert its taxing power over the taxpayer.[99] The U.S. Supreme Court granted certiorari.[100]

Quill liberalized the due process standard for states to levy taxes on out-of-state sellers. The Supreme Court held that physical presence was not required to establish minimum contacts.[101] The Court agreed with the North Dakota Supreme Court that Quill had "purposefully directed its activities at North Dakota residents, [and] that the magnitude of those contacts is more than sufficient for Due Process purposes."[102] Further, the Court found that the use tax at issue was related to the benefits that Quill received by gaining access to the North Dakota market.[103] The Court noted that the imposition of taxes on a mail-order business is justified when that business is engaged in "continuous and widespread solicitation of business within a state."[104] A business engaging in such solicitation is deemed to have "fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign."[105] The Court went on to explicitly overrule *National Bellas Hess* regarding its due process physical presence requirement, stating that new developments in the law of due process vitiate the need to have a physical presence in order to establish a nexus under the due process clause.[106] The Court officially made it much easier for states to justify the imposition of taxes under the due process clause. However, the Court chose to uphold *National Bellas Hess* in its dormant commerce clause analysis.

The Court sided with the appellant's commerce clause challenge by upholding *National Bellas Hess*, which prohibited state taxes upon mail-order businesses that had no physical presence within the taxing state.[107] The Court stated that in the context of the commerce clause, including the dormant commerce clause, a bright-line rule that limits state power to tax is more beneficial than not.[108] The Court favored a bright-line rule that clearly set the boundaries of states' authority to levy taxes on interstate commerce and reduced litigation costs over those taxes.[109] The Court also reasoned that a bright-line physical presence rule for sales and use taxes gave businesses predictability that fostered investment in those businesses.[110] The Court linked the physical presence rule of *National Bellas Hess* with the growth of the mail-order industry over the preceding 25 years.[111]

Kill *Quill*

In the years following the *Quill* decision, states enacted laws attempting to circumvent the physical presence standard of the commerce clause.[112] Several states required online retail sellers to collect sales tax if the retailer maintained some sort of physical presence within the taxing state, most notably in-state "affiliates" that sell products by using the retailer's website. In 2017 the state of Massachusetts enacted a law requiring its tax collection agency, the Department of Revenue, to direct large, out-of-state sellers to collect and remit sales and use taxes to the state.[113] The underlying theory of the new law is that these out-of-state, online sellers have an "in-state presence" because their transactions involve software, also known as "cookies," stored on the Massachusetts customers' in-state devices.[114]

In 2017 Colorado also passed its own "Kill *Quill*" law, requiring out-of-state sellers to notify their customers of the state's sales and use tax requirements and to report information about

[98] *Id.*

[99] *Id.* at 305.

[100] *Id.*

[101] *Id.* at 308.

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] *Id.*

[106] *Id.*

[107] *Id.* at 311.

[108] *Id.* at 314.

[109] *Id.*

[110] *Id.*

[111] *Id.*

[112] Tim Anderson, "Two Midwest States Join South Dakota With 'Kill *Quill*' Laws; Goal Is to Collect Remote Sales Taxes," The Council of State Governments (May 2017).

[113] *Id.*

[114] *Id.*

their customers to Colorado's tax collection agency.[115] The appellant, a retailers' trade association, filed suit alleging that the law violated the commerce clause by discriminating against interstate commerce and placing an undue burden upon interstate commerce.[116] The Court upheld Colorado's law (and the *Quill* physical presence standard, by extension), but Justice Anthony Kennedy's concurrence raised the possibility of overturning *Quill* in the future.[117]

Kennedy wrote that in *Quill*, the Court should have reconsidered *National Bellas Hess* in light of *Complete Auto*'s four-pronged test as well as social and technological advances that have taken place since *National Bellas Hess* was decided in 1967.[118] Kennedy then noted that "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. After all, 'interstate commerce may be required to pay its fair share of state taxes.'"[119] Kennedy then noted that when *Quill* was decided in 1992, the mail-order industry was large, and internet-based commerce was "in its infancy," but in 2008 internet-based commerce was a multitrillion-dollar industry.[120] After noting that most major retailers are now "a click away" for customers,[121] he wrote that in light of changes in technology and consumer sophistication, "it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*."[122] "A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier."[123] Kennedy's concurrence provided fertile ground for *South Dakota v. Wayfair*, in which Kennedy would write the opinion for the majority.

South Dakota v. Wayfair: The Economic Nexus Standard

South Dakota v. Wayfair originated from South Dakota's "complementary sales and use tax regime."[124] Under this regime, South Dakota taxes the sales of retail goods within the state.[125] In the event that the seller does not remit sales taxes to the state, then the in-state purchasers will be responsible for paying a use tax at the same tax rate.[126] Under *National Bellas Hess* and *Quill* (each interpreting the commerce clause), South Dakota was not able to tax sales made by sellers unless the sellers maintained a physical presence within the state.[127] In 2016 South Dakota passed S. 106, which allowed for the collection of sales taxes from remote sellers who had no physical presence in the state but nevertheless "delivered more than $100,000.00 of goods and services into the state or engage in 200 or more separate transactions for the delivery of goods and services into the state."[128] The Legislature, likely anticipating a challenge to this law under *Quill*, limited the law's retroactive application and then allowed for the law to be stayed until its constitutionality could be "clearly established."[129]

Respondents Wayfair Inc., Overstock.com Inc., and Newegg Inc. were retail sellers with no physical presence in South Dakota.[130] Since each company surpassed the $100,000 or more in sales or 200-or-more-transactions threshold of the law, South Dakota filed an action to require each company to collect and remit sales tax to the state.[131] The state asserted that the law at issue could not stand in light of *National Bellas Hess* and *Quill*, but requested that the U.S. Supreme Court review those decisions in light of subsequent economic changes.[132]

115 *Direct Marketing Association*, 135 S. Ct. at 1125.

116 *Id.* at 1129.

117 *Id.* at 1134.

118 *Id.* at 1134-1135.

119 *Id.* at 1135.

120 *Id.*

121 *Id.*

122 *Id.*

123 *Id.*

124 *Wayfair*, 138 S. Ct. at 2088.

125 *Id.*

126 *Id.*

127 *Id.*

128 *Id.* at 2089.

129 *Id.*

130 *Id.*

131 *Id.*

132 *Id.*

South Dakota v. Wayfair: The Interests at Stake

This case caught the attention of several amici, including Little Rock, Arkansas, a retail sellers' lobby, a retailers association, law professors and economists, U.S. senators, organizations representing governors and municipalities, as well as 40 other states that supported South Dakota's position that the physical presence rule should be abrogated. The South Dakota Retailers Association asserted in its amicus brief that the physical presence rule puts in-state retailers at a competitive disadvantage when compared with remote sellers that are exempt from collecting sales and use tax.[133] Internet sales nationally, as well as in South Dakota, have grown at a higher rate than the retail industry as a whole (which includes in-state retail sales).[134]

In their amicus brief, Colorado and 40 other states argued that *Quill*'s physical presence rule "impairs States' ability to deliver crucial government services."[135] Citing *Direct Marketing Association*, these states asserted that the physical presence rule results in a "startling revenue shortfall" with no constitutional justification.[136] States have historically relied on sales and use taxes to fund their government functions, including educational systems, healthcare services, and infrastructure projects.[137] These states asserted that remote sellers are using the physical presence rule to their advantage by advertising their products as being "tax free, thus placing in-state retailers at a competitive disadvantage."[138] In addition to this competitive disadvantage, the amici cited "concomitant unfairness" brought on by *Quill*, such as rental rates for retail space becoming depressed, in-state retailers employing fewer state residents, and the erosion of local tax bases from lower economic activity.[139] Finally, the amici cited the statistic that states' sales tax losses have trended upward, with e-commerce sales growing 15.5 percent from 2016-2017, but total retail sales growing only 4 percent over that period.[140]

The South Dakota Retailers Association cited the competitive disadvantage that in-state retailers faced relative to remote sellers.[141] Also, anticipating that the respondents would argue that compliance costs of remitting sales taxes to South Dakota (and other states in which they ship goods or services) would be onerous, the association posited that since over 100 online retailers were voluntarily collecting and remitting sales tax on transactions with South Dakota customers, any difficulty of compliance would be nonexistent.[142] Moving away from the competitive disadvantage argument, another amicus curiae approached this case from industry-focused and economic perspectives.[143]

Amici curiae Retail Litigation Center Inc. and 21 retail and wholesale distribution trade organizations argued that the retail industry had transformed in ways that "disprove the economic assumption of *Quill* and *Bellas Hess*."[144] *Quill* and *National Bellas Hess* were decided on the assumptions that (1) remote sellers would not survive if they were required to collect and remit sales taxes; (2) that a retailer that is not physically present in a state could not be persistently active there; (3) that if remote sellers were not required to collect and remit sales taxes, their sales would be tax exempt; and (4) that the burden would be onerous for remote sellers to collect sales taxes.[145] The amici curiae posited that the explosion of remote retail could not have been foreseen when *National Bellas Hess* and *Quill* were decided, and that they should be reevaluated in light of "the dramatic technological and social changes that have taken place in our increasingly interconnected economy."[146] Further, the amici noted that e-commerce earns a profit without the exemption established by *Quill*.[147] The amici then

[133] Amicus brief submitted by South Dakota Retailers Association, 6.

[134] *Id.*

[135] Amicus brief submitted by Colorado and 40 other states.

[136] *Id.*, citing *Direct Marketing Association* at 1134-35.

[137] *Id.*

[138] *Id.*

[139] *Id.*

[140] *Id.* at 9.

[141] Amicus brief submitted by South Dakota Retailers Association at 6.

[142] *Id.*

[143] Amicus brief of Retail Litigation Center Inc. et al.

[144] *Id.* at 10.

[145] *Id.*

[146] *Id.* at 11, citing *Direct Marketing Association* at 1134-35.

[147] *Id.* at 14.

argued that online-only retailers are persistently active and economically present despite physical absence.[148]

South Dakota v. Wayfair: The Majority Opinion

The majority opinion was an opportunity for Kennedy to express the majority's dissatisfaction with *Quill* as an "incorrect interpretation of the Commerce Clause," which he touched on in his concurrence in *Direct Marketing Association* three years earlier.[149] Kennedy began the majority opinion by recanting commerce clause jurisprudence from *Gibbons v. Ogden* leading up to *Quill* in 1992.[150] Kennedy noted that the physical presence rule had been the "target of criticism over many years from many quarters."[151] Kennedy then addressed *Quill* directly, stating that the decision was "premised on assumptions that are unfounded" and was "riddled with internal inconsistencies."[152] He wrote that *Quill* effectively created an "inefficient 'sales tax loophole,'" giving a competitive advantage to out-of-state businesses.[153] Noting that while nexus rules are necessary to enforce the dormant commerce clause's constraints upon states, the majority wrote that the Court should craft rules that are "appropriate to the twenty-first century, not the nineteenth."[154] The Court posited that the physical presence rule is becoming "further removed from economic reality" and is causing "significant revenue losses to the States."[155]

The majority in *Wayfair* reinterpreted the commerce clause outside the confines of *Quill*'s physical presence rule.[156] The Court held that the commerce clause does not require a physical presence to establish a nexus with a state before that state can tax an interstate transaction.[157] The Court then stated that *Quill* functioned to create market distortions and that *Quill*'s application of an "arbitrary, formalistic distinction" should be avoided by the Court, rather than embraced.[158]

In the Court's view, a business's physical presence within a state will enhance a business's connection with the state, but "it is an inescapable fact of modern commercial life that a substantial amount of business is transacted [with no] need for physical presence within a state in which business is conducted."[159] A specific internal consistency of *Quill* is that *Quill* acknowledges that due process is satisfied regardless of a business's lack of physical presence within the taxing state.[160] The majority further noted that the reasons given in *Quill* for rejecting the physical presence rule for due process analysis also apply to the question whether physical presence is required for an out-of-state seller to be required to collect and remit sales tax.[161] Finally, the majority held that "physical presence is not necessary to create a substantial nexus."[162] The Court went on to dismiss the appellants' argument that dispensing with the physical presence rule will unduly burden interstate commerce by exposing out-of-state businesses to the costs of having to comply with sales tax collection burdens in multiple states.[163]

The Court explained that "the Commerce Clause was designed to prevent States from engaging in economic discrimination so they would not divide into isolated, separable units."[164] However, the commerce clause does not serve to "relieve those engaged in interstate commerce from their just share of state tax burden," or to "create market distortions" by putting in-state businesses at a competitive disadvantage compared with out-of-state businesses.[165] Under the *Quill* paradigm, out-of-state businesses can charge "*de facto*" lower prices than in-state businesses by avoiding the regulatory costs of

[148] *Id.* at 15.

[149] *Wayfair*, 138 S. Ct. at 2092.

[150] *Id.* at 2080-2092.

[151] *Id.* at 2092, citing *Direct Marketing Association* at 1148, 1150-1151.

[152] *Id.* at 2092.

[153] *Id.*

[154] *Id.*

[155] *Id.*

[156] *Id.*

[157] *Id.*

[158] *Id.*

[159] *Id.* at 2093.

[160] *Id.*

[161] *Id.*

[162] *Id.*

[163] *Id.*

[164] *Id.* at 2094.

[165] *Id.*

collecting sales tax.[166] *Quill* amounted to a "judicially created tax shelter."[167] The Court then turned to how *Quill*'s inefficient operation enables large out-of-state businesses at the expense of smaller in-state businesses.[168]

The majority posed the hypothetical fact pattern of an in-state furniture seller that maintains a small warehouse within South Dakota versus a larger furniture seller that maintains a large warehouse just over the state's border and operates a sophisticated website with a virtual showroom.[169] Under *Quill*, the in-state seller would have to collect and remit sales tax, while the out-of-state seller would be exempt from a sales tax burden even if it maintained a larger presence and shipped more of its goods into the South Dakota market.[170] In light of this fact pattern, the Court wrote that modern e-commerce is not aligned with *Quill*.[171] Under *Quill*, the in-state business with a small warehouse would be subject to a sales tax burden to which the larger, more pervasive out-of-state company would not be subject.[172] The "bright line test" of *Quill* now results in "arbitrary consequences" that should not occur in light of the "increasingly interconnected economy" that brings buyers "closer to most major retailers" than ever before (regardless of how far away the buyer is from the retailer).[173]

The Court overturned *Quill*, stating that *stare decisis* is "not an inexorable command."[174] The physical presence rule of *Quill* is "unsound and incorrect."[175] Rather, a business can establish a substantial nexus under the commerce clause if the business "avails itself of the substantial privilege of carry on business in that jurisdiction."[176] *Wayfair* established the test to be applied to a state tax on interstate commerce that is challenged against the commerce clause.

The courts must look to whether the out-of-state business has established economic and other virtual contacts with the taxing state.[177] Further, a state's tax on interstate commerce (namely, a sales or use tax) will be upheld if that tax contains safe harbors for businesses that transact a relatively small amount of business with customers in that state; South Dakota's law applied only to sellers that shipped more than $100,000 of goods or services into the state or engaged in 200 or more separate transactions to sell goods or services into that state annually.[178] *Wayfair* expanded states' power to levy taxes on interstate commerce, but its full effects on states and commerce have yet to be determined.

Wayfair's Possible Effects on Federalism

Critics of *Wayfair*'s majority opinion posit that this decision expands states' power to tax to such an extent that Congress would not be able to enforce its own laws under the commerce clause.[179] As a practical matter, Congress has been unable to evaluate each and every state and local law that could arise in the wake of *Quill*.[180] As a consequence, the dormant commerce clause functions to reserve Congress's power to regulate interstate commerce by allowing the judiciary to strike down any laws that place an undue burden on interstate commerce.[181] Thus the judiciary is tasked with preserving the federalist scheme.[182] Critics of *Wayfair* posit that states are now empowered to levy taxes on out-of-state businesses that did not vote for those taxes.[183]

Wayfair's Effects on Businesses

Critics of *Wayfair* claim that this decision potentially poses a steep compliance burden to

[166] *Id.*
[167] *Id.*
[168] *Id.*
[169] *Id.*
[170] *Id.*
[171] *Id.* at 2095.
[172] *Id.*
[173] *Id.*
[174] *Id.* at 2096.
[175] *Id.* at 2099.
[176] *Id.*

[177] *Id.*
[178] *Id.*
[179] Jessica Inscore, "The Amazon Argument: An Examination of *South Dakota v. Wayfair* and a Discussion of Its Implications," 41(2) *Campbell L. Rev.* 531, 554 (Spring 2019).
[180] *Id.* at 555.
[181] *Id.*
[182] *Id.*
[183] *Id.*

small businesses.[184] Steve Forbes said that while internet-based retailers have replaced mail-order catalog retailers (which the Court in *Quill* considered when deciding that case), the concept of remote selling has not changed.[185] After *Wayfair*, out-of-state businesses that have operated without sales or use tax burdens are now faced with the possibility of having to comply with over 10,000 state and local jurisdictions.[186] The Court in *Wayfair* held that South Dakota's law comported with the commerce clause because it included two safe harbors that allowed smaller out-of-state businesses to sell goods or services in South Dakota tax free.[187] Critics claim that these safe harbors provide little to no protection to small businesses in light of the prevalence of internet-based retail, which "constitutes a considerable amount of business."[188]

In 2017 the Government Accountability Office studied the possible effects of expanding states' tax authority over out-of-state businesses.[189] The GAO estimated that under then-current (pre-*Wayfair*) law, state and local governments were able to collect about 75 to 80 percent of the taxes that would be owed if 100 percent of out-of-state sellers were required to collect and remit sales tax on all sales that are made to the taxing states.[190] For the typical business-to-consumer retail transaction (such as those conducted by Wayfair and Overstock), the GAO found that (before *Wayfair*) internet-based retailers were paying a higher percentage of sales and use taxes to states relative to other types of out-of-state sellers, such as catalog retailers or e-marketplaces (such as eBay.com).[191] Thus, the compliance cost argument that the *Wayfair* decision will lead to an unreasonable compliance burden for out-of-state businesses is unconvincing in light of the GAO's statistic. On the contrary, out-of-state businesses were adapting to the need to collect and remit taxes before *Wayfair* was decided. Adding credence to the author's position is the fact that some internet retailers have voluntarily entered into agreements with states to collect and remit sales taxes, even if the retailers maintained no physical presence within those states.[192]

Wayfair's Effect on States' Revenues

The GAO estimated that states could collect about $8 billion to $13 billion if states' power to levy tax on interstate commerce were to be expanded.[193] This figure is much more relevant in light of the GAO's statistic that voluntary compliance among state residents with use tax payments is extremely low.[194] *Wayfair* makes it possible for states to levy sales taxes in order to recoup the taxes that they otherwise would not collect in use taxes.[195]

Possible Increases in Compliance Costs for Businesses

Businesses would likely incur increased costs to comply with new state sales tax requirements.[196] The GAO grouped the various costs associated with tax collection among multiple states into the following categories: software-related costs, audit and assessment compliance costs, and costs associated with research and liability.[197] The GAO found that out-of-state businesses could face high upfront costs to establish software to comply with sales taxes among different states.[198] Although many standard tax compliance software programs generally include sales tax functionality, they do not always function for compliance in multiple taxing jurisdictions.[199]

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[184] *Id.* at 549.

[185] *Id.*, citing Steve Forbes, "Steve Forbes: Internet Sales Tax Would Be Fatal for Small Businesses," *Fox News*, June 14, 2018.

[186] *Id.*, citing Forbes.

[187] *Wayfair*, 138 S. Ct. at 2099.

[188] Inscore, *supra* note 179 at 550, citing *Wayfair*, 138 S. Ct. at 2099.

[189] Government Accountability Office, "Sales Taxes: States Could Gain Revenue From Expanded Authority, but Businesses Are Likely to Experience Compliance Costs" (Nov. 2017).

[190] *Id.* at 8.

[191] *Id.*

[192] *Id.* at 10.

[193] *Id.* at 11. This GAO report was released in 2017, the year before *Wayfair* was decided. Although the data in this report predates *Wayfair*, its relevance comes from the GAO's use of this data to extrapolate forward and determine what a post-*Wayfair* tax paradigm could resemble.

[194] GAO, *supra* note 189, at 14.

[195] *Id.*

[196] *Id.* at 15.

[197] *Id.*

[198] *Id.* at 16.

[199] *Id.*

Therefore, businesses that sell goods to customers in multiple states are forced to purchase specialized, state-specific sales tax software programs.[200]

Out-of-state businesses incur separate costs involved with sales tax collection and sales tax remittance, as well as audit and assessment costs once taxes are collected.[201] Also, there are often start-up costs incurred before tax collection.[202] Some software providers determine software costs by the volume of sales that a business transacts, meaning that businesses that engage in a high volume of transactions will incur higher software costs relative to smaller businesses.[203] Considering these factors in the aggregate, businesses that operate in multiple jurisdictions (with or without a physical presence) will incur a greater amount of administrative work, and will incur higher administrative costs as a result.[204] While all out-of-state sellers will incur the same software and compliance obligations, these costs will be highest for businesses that do not have this infrastructure in place and therefore have to install multistate tax collection software.[205]

Conclusion

South Dakota v. Wayfair greatly changed commerce clause jurisprudence by creating a new standard for businesses to establish a nexus for state tax purposes.[206] States are now free to levy taxes on interstate commerce so long as the business selling the good or service within the state maintains an economic presence in the state.[207] The majority in *Wayfair* jettisoned the physical presence rule of *Quill v. North Dakota*.[208] One lesson of *Wayfair* is that the Supreme Court could disregard *stare decisis* if it concludes that the technological and economic realities render what practitioners and scholars view as a valid doctrine (the physical presence rule of *Quill*) to be obsolete.[209]

Though the majority in *Wayfair* makes a compelling case, there are factors that should be considered by states seeking to levy sales taxes on out-of-state sellers. *Wayfair* expands states' tax power on interstate commerce; however, the dormant commerce clause prohibits taxes on out-of-state sellers that place an undue burden on interstate commerce. State legislatures should exercise care in determining what an appropriate sales dollar amount or transaction amount should be for smaller out-of-state sellers; those thresholds should accurately reflect the sizes and volume of transactions that are common to that state's economy. The Supreme Court in *Wayfair* established these threshold requirements, but South Dakota's thresholds may not reflect the norms of small retail businesses that ship goods to other, more populous states. Courts will likely overturn laws with nexus thresholds that do not accurately reflect the volume or dollar amounts being transacted by out-of-state sellers. Therefore, it is critical for state legislatures to draft post-*Wayfair* legislation (nexus thresholds) that coincide with the markets in their respective states. Legislatures should hold hearings and accept testimony from expert witnesses who can establish what the dynamics of that state's market are in relation to interstate commerce. This will help ensure that proposed legislation complies with the Supreme Court's threshold requirements in *Wayfair* and, by extension, the dormant commerce clause. States that exercise care in writing this legislation will foster a healthy market in the state and lessen the risk that a court will strike the legislation down. ■

[200] *Id.*

[201] *Id.*

[202] *Id.*

[203] *Id.*

[204] *Id.*

[205] *Id.* at 17.

[206] *Wayfair*, 138 S. Ct. at 2099.

[207] *Id.*

[208] *Id.*

[209] *Id.*