



Volume 14 (2017) | ISSN 1932-1821 (print) 1932-1996 (online)
DOI 10.5195/taxreview.2017.60 | <http://taxreview.law.pitt.edu>

ARTICLES

THE NEW NORMAL FOR SALES AND USE TAX IN THE UNITED STATES: WILL A STATE CHALLENGE TO SUPREME COURT PRECEDENT OVERHAUL SALES AND USE TAX COMPLIANCE FOR ONLINE RETAILERS?

Brian Howsare



This work is licensed under a Creative Commons Attribution-NonCommercial-No Derivative Works 3.0 United States License.



This journal is published by the [University Library System](#) of the [University of Pittsburgh](#) as part of its [D-Scribe Digital Publishing Program](#), and is cosponsored by the [University of Pittsburgh Press](#).

ARTICLES

THE NEW NORMAL FOR SALES AND USE TAX IN THE UNITED STATES: WILL A STATE CHALLENGE TO SUPREME COURT PRECEDENT OVERHAUL SALES AND USE TAX COMPLIANCE FOR ONLINE RETAILERS?

Brian Howsare *

Perhaps the foremost tax challenge faced by online retailers today relates to sales and use tax compliance. When an online retailer makes a sale in the United States, it may be shipping its products to one of roughly 10,000 different sales tax jurisdictions.¹ For retailers lacking substantial tax resources, navigating the different sales and use tax laws of these jurisdictions—determining the applicable state and local tax rates, ascertaining the correct tax base, collecting tax from customers, filing the appropriate returns, and remitting proper payment—is a nearly insurmountable task. In order to minimize the scope of this task and make sales and use tax compliance a manageable undertaking, it is imperative for retailers to know exactly which states’ sales tax laws bind them. That is, retailers must know which states can legally require them to collect tax and file returns, and which states cannot.

Fortunately, since 1992, mail-order and online retailers have had a relatively straightforward litmus test to determine whether they must charge sales tax to a customer: If the seller has a physical presence in the state to which goods are shipped, it must apply the state’s tax (and applicable local taxes); if the seller has no physical presence in the state, the retailer need not charge sales tax. This “physical presence” standard, although relied on by the

* Brian Howsare is a Florida attorney practicing in the area of state and local taxation and specializing in indirect tax.

¹ As reported by tax software company Vertex. Joseph Henchman & Richard Borean, *State Sales Tax Jurisdictions Approach 10,000*, TAX FOUND. (Mar. 24, 2014), <http://taxfoundation.org/blog/state-sales-tax-jurisdictions-approach-10000>.

vast majority of online retailers in this country, has been eroding rapidly over the past decade as a result of state laws that push the limits of the type of contacts that can constitute physical presence in a state. This erosion culminated in 2015 in *Direct Marketing Ass'n v. Brohl*, in which Justice Anthony Kennedy, in a concurring opinion, implored the Supreme Court to reexamine whether the physical presence standard should continue to be recognized at all. This has prompted multiple states to enact laws that directly challenge the physical presence standard with the aim of eliminating it altogether.

How these challenges are decided will drastically impact the development of one of the country's most vital and fastest growing economic segments—online retail. This article is intended to help practitioners in the online retail industry plan for the inevitable upheaval resulting from these challenges by predicting how these challenges will play out and examining the implications for online retailers. The information in this article is provided in three sections. First, this article briefly outlines the origins and subsequent erosions of the physical presence standard leading to the *Direct Marketing* concurrence and the legislation it prompted. Second, this article examines whether the Supreme Court will hear a challenge to the physical presence standard, how such a challenge would be decided, and what overturning the standard would mean for retailers. Finally, this article provides commentary on what online retailers can expect as the challenges are decided.

I. THE PHYSICAL PRESENCE STANDARD: ORIGINS AND EROSIONS

The current physical presence standard is rooted in the Commerce Clause of the United States Constitution, which states that the United States Congress has the power to regulate commerce “among the several states.”² Through nearly two centuries of Supreme Court jurisprudence, this grant of power to the U.S. Congress has been interpreted to mean that state legislatures are not permitted to impose taxes or take any other action that will impede commerce among the states.³ This idea is referred to as the

² U.S. CONST. art. I, § 8, cl. 3.

³ See *Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787, 1808 (2015) (striking down a Maryland state tax that would hinder interstate commerce in conflict with the restrictions read into the

dormant Commerce Clause, which is the foundation of state tax nexus laws and the physical presence requirement.⁴

A. *The Quill/Bellas Hess Physical Presence Standard*

In 1992, the Supreme Court issued its opinion in *Quill Corp. v. North Dakota*, the Court's most recent decision regarding a state's authority to require an out-of-state vendor to collect and remit sales tax on the sale of goods to an in-state customer.⁵ Quill, a Delaware company, was a mail-order vendor of office supplies that made mail-order and telephone sales to about 3,000 customers in North Dakota during the period at issue.⁶ Quill delivered all of its merchandise to its North Dakota customers via mail or common carrier from out-of-state locations.⁷ Quill did not have any outlets or personnel in North Dakota.⁸

The North Dakota Tax Commissioner claimed that Quill was required to collect North Dakota use tax on sales where Quill shipped goods to customers in North Dakota.⁹ Quill, however, disagreed, relying on the physical presence precedent set in the Supreme Court's 1967 decision of *National Bellas Hess, Inc. v. Department of Revenue*.¹⁰ Specifically, in *Bellas Hess*, the Court held that under the dormant Commerce Clause, a state cannot

Commerce Clause); *Gibbons v. Ogden*, 22 U.S. 1, 199–200 (1824) (first interpreting the Commerce Clause as imposing restrictions on state action that would interfere with interstate commerce).

⁴ See *Okl. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179 (1995) (explaining that the Court has “consistently held [the Commerce Clause] to contain a further, negative command, known as the dormant Commerce Clause, prohibiting certain state taxation even when Congress has failed to legislate on the subject”).

⁵ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁶ *Id.* at 302.

⁷ *Id.*

⁸ *Id.* at 301.

⁹ *Id.* at 303. In North Dakota, the use tax is, for all practical purposes, the equivalent of the state's sales tax, but is required to be collected by out-of-state vendors. See N.D. CENT. CODE § 57-40.2-07 (2016). The use tax in *Quill* imposed a collection duty on every vendor who advertised in North Dakota three times in a single year. *Quill*, 504 U.S. at 302–03.

¹⁰ *Quill*, 504 U.S. at 301 (citing *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 758 (1967)).

require a seller to collect the state's sales or use tax when the seller's "only connection with customers in the State is by common carrier or the United States mail."¹¹

Notwithstanding the Supreme Court's holding in *Bellas Hess*, the North Dakota Supreme Court sided with the State Tax Commissioner, reasoning that the physical presence requirement established in *Bellas Hess* was obsolete as a result of "tremendous social, economic, commercial, and legal innovations" occurring since 1967.¹² Contrary to the state court's reasoning, however, the U.S. Supreme Court stood by its precedent and reaffirmed the physical presence requirement in *Quill*.¹³ In its reasoning, the Court acknowledged the validity of the lower court's points but explained that the utility and convenience of having a bright-line test outweighed the reasons for changing the physical presence standard.¹⁴ The Court further explained that, to the extent a change is necessary, Congress is the government body best suited to make such a change.¹⁵

B. Erosions of the Physical Presence Standard

Although what exactly constitutes a "physical presence" for purposes of the dormant Commerce Clause has never been universally defined, states generally find a physical presence when a vendor has within a state: any physical location (e.g., an office, distribution center, salesroom, warehouse or other place of business); tangible personal property within the state (e.g., inventory, vehicles, or rented/leased personal property); or any employees, agents, or independent contractors working in the state.¹⁶ A substantial physical presence does not equate to a "slightest presence," but state nexus

¹¹ *Id.* at 301 (quoting *Bellas Hess*, 386 U.S. at 758).

¹² *State ex rel. Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 208 (N.D. 1991).

¹³ *Quill*, 504 U.S. at 317–18.

¹⁴ *Id.* at 316, 317 (explaining that "a bright-line rule in the area of sales and use taxes . . . encourages settled expectations and . . . fosters investment by businesses and individuals" and that "the continuing value of a bright-line rule in this area and the doctrine and principles of stare decisis indicate that the *Bellas Hess* rule remains good law").

¹⁵ *Id.* at 318.

¹⁶ *See, e.g.*, CAL. REV. & TAX CODE § 6203(c) (2016) (defining the term "retailer engaged in business in this state"); FLA. STAT. § 212.06(2) (2016) (defining the term "dealer").

statutes are often broad enough to encompass nominal levels of physical presence.¹⁷

In the years following the *Bellas Hess* and *Quill* decisions, the mail-order industry evolved into the online sales industry, and the amount of sales involving shipments of goods into states from out-of-state retailers increased exponentially.¹⁸ As online sale revenues increased, so too did the tax revenues that states were not able to collect.¹⁹ As a result, states enacted various types of legislation to test the limits of the physical presence standard.²⁰ Such laws have colloquially been referred to as “Amazon laws,” since they were originally enacted to target sales by Amazon.com.²¹

One type of Amazon law relates to “click-through nexus.” Click-through nexus targets relationships similar to Amazon’s affiliate program where an in-state person would host a website (the affiliate website) containing a link to a retailer’s website. When a visitor to the in-state person’s website uses the link to access the out-of-state retailer’s website and then makes a purchase, the in-state person receives a commission for the click through. Click-through laws provide that the out-of-state retailer has a

¹⁷ See *Quill*, 504 U.S. at 315 n.8 (noting that the presence of a few floppy diskettes owned by Quill did not establish substantial physical presence); *Orvis Co. v. Tax Appeals Tribunal*, 86 N.Y.2d 165, 178 (N.Y. Ct. App. 1995) (explaining that a vendor need only have “demonstrably more than a ‘slightest presence’” in the state to be subject to New York’s sales and use tax collection requirements, and finding this standard to be satisfied by company employees making periodic visits to customers in the state).

¹⁸ Under one estimate, total e-commerce sales surpassed \$340 billion in 2015 and are projected to reach \$534 billion by 2019. Jennifer McLoughlin, *Quill in States’ Crosshairs as New Nexus Standards Enacted*, DAILY TAX REP., Mar. 31, 2016, at H-1. Compare this to estimations of the size of the mail-order industry at the time of the *Bellas Hess* and *Quill* decisions: \$2.4 billion in 1967 and \$183.3 billion in 1989. *State ex rel. Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 209 (N.D. 1991).

¹⁹ See, e.g., S. 106, 91st Leg. Assemb. § 8 (S.D. 2016) (explaining that “the inability to effectively collect the sales or use tax from remote sellers . . . is seriously eroding the sales tax base of this state, causing revenue losses and imminent harm to this state through the loss of critical funding for state and local services”).

²⁰ See, e.g., GA. CODE ANN. § 48-8-2(8)(K), (L) (2016) (imputing the physical presence of an affiliate entity to an out-of-state vendor, a concept known as “affiliate nexus”); N.Y. TAX LAW § 1101(b)(8)(vi) (McKinney 2015) (declaring a “click-through” relationship between unrelated parties to be sufficient physical presence).

²¹ New York was likely the first to enact an Amazon law, with its click-through nexus law taking effect June 1, 2008. Although originally drafted with Amazon.com in mind, Amazon now has a physical presence in many states due to its vast expansion. As a result, the Amazon laws now have a more substantial impact on online retailers of a relatively smaller size.

physical presence within the state by virtue of the retailer's commission relationship with the in-state affiliate.²²

Another type of Amazon law enacted by states is the "notice law." Notice laws require out-of-state retailers that do not collect the state's sales tax to provide specified use tax notices to their customers and to the tax authorities.²³ The required notices may include: providing notice to customers that they may have a use tax obligation as a result of the transaction; providing customers with an annual summary of their transactions with the vendor; and/or annually providing to the state a list of in-state customers, including the customers' names, addresses, and the total dollar amount of purchases made during the year.²⁴ States can leverage this information to spur consumer use tax compliance by both raising consumer awareness of use tax obligations and by increasing the tax authorities' enforcement capabilities.

While the Supreme Court has not weighed the constitutionality of Amazon laws and similar legislation that pushes the boundaries of the physical presence standard, such laws have been challenged in lower courts and have generally been upheld.²⁵ Some challenges have sought certiorari before the Supreme Court, but none have received it.²⁶ On their own, these lower court victories would likely be sufficient to embolden states to draft increasingly aggressive physical presence laws, thereby continuing the

²² See, e.g., N.Y. TAX LAW § 1101(b)(8)(vi). Such laws typically require that the referrals to the retailer generate a certain amount of sales, usually \$10,000. See *id.*

²³ Almost all states have a use tax that acts as a reciprocating tax to the sales tax. In instances where the state cannot require a vendor to collect sales tax, the purchaser is generally required to self-assess and remit use tax. Therefore, in theory, the same amount of tax is due the state regardless of whether it can force the vendor to collect the tax. Meaningful enforcement of the use tax, however, is practically impossible for most states, and consumer awareness of use tax remittance requirements is relatively low as well. As a result, the vast majority of sales and use tax revenues that states do not receive are associated with purchases from out-of-state vendors.

²⁴ See, e.g., OKLA. STAT. tit. 68, § 1406.2(A) (2016); LA. STAT. ANN. § 47:309.1 (2016); COLO. CODE REGS. § 39-21-112(3.5)(2), (3), (4) (2016).

²⁵ See, e.g., *Direct Mktg. Ass'n v. Brohl*, 814 F.3d 1129, 1147 (10th Cir. 2016) (upholding Colorado's notice law); *Overstock.com, Inc. v. N.Y. Dep't of Taxation & Fin.*, 20 N.Y.3d 586, 597 (2013) (upholding New York's click-through nexus law).

²⁶ See, e.g., *Overstock.com, Inc. v. N.Y. Dep't of Taxation & Fin.*, 134 S. Ct. 682 (2013); *KFC Corp. v. Dep't of Revenue*, 565 U.S. 817 (2011) (denying certiorari in both cases).

erosion of the physical presence standard. In a recent Supreme Court case, however, Justice Kennedy delivered a digression that may end up transforming the gradual diminution of the standard into a complete washout.

In March 2015, the Supreme Court issued an opinion in the case of *Direct Marketing Ass'n v. Brohl*, a case related to (but not weighing the constitutionality of) Colorado's notice requirement law.²⁷ In a concurring opinion, Justice Kennedy declared that it was time for the Court to take a fresh look at the *Quill/Bellas Hess* physical presence standard, stating that:

Because of *Quill* and *Bellas Hess*, States have been unable to collect many of the taxes due on these purchases. California, for example, has estimated that it is able to collect only about 4% of the use taxes due on sales from out-of-state vendors. The result has been a startling revenue shortfall in many States, with concomitant unfairness to local retailers and their customers who do pay taxes at the register

Given [recent] changes in technology and consumer sophistication it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier. It should be left in place only if a powerful showing can be made that its rationale is still correct *The legal system should find an appropriate case for this Court to reexamine Quill and Bellas Hess.*²⁸

Justice Kennedy's invitation found a receptive audience with many state legislatures and tax authorities. Several jurisdictions soon implemented laws—so-called “kill-*Quill*” laws—aimed at out-of-state retailers that would directly and indirectly challenge the so-called bright-line standard that has been in place for decades.

C. Revisiting the Physical Presence Standard

Since the issuance of the *Direct Marketing* opinion, multiple states have enacted laws or rules that appear to be an affirmative, if not eager, response to Justice Kennedy's invitation to revisit *Quill*. Alabama was the first state to take action, promulgating a rule directly at odds with *Quill*.²⁹ Alabama's

²⁷ *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124 (2015).

²⁸ *Id.* at 1135 (Kennedy, J., concurring) (internal citations omitted, emphasis added).

²⁹ See ALA. ADMIN. CODE r. 810-6-2-.90.03(1) (2016).

regulation provides that “out-of-state sellers who lack an Alabama physical presence but who are making retail sales of tangible personal property into the state have a substantial economic presence in Alabama for sales and use tax purposes and are required to register” with the Department of Revenue and remit tax when sales into the state exceed \$250,000.³⁰

Although not the first to respond, South Dakota has made its intentions the most clear. On March 22, 2016, the governor signed legislation requiring all out-of-state retailers, regardless of any physical presence, to collect and remit sales tax to the extent that either: (1) the retailers generate over \$100,000 of gross revenues from sales of products or services delivered into the state; or (2) the retailers sell products or services delivered into the state in 200 or more separate transactions.³¹

Perhaps more important than the requirement on vendors, however, are the procedural aspects of the law. The law permits South Dakota to bring a declaratory judgment action in circuit court against any person meeting the above criteria that does not register.³² The state does not have to first assess tax prior to bringing suit.³³ The law directs the circuit court to act on the declaratory judgement “as expeditiously as possible” and to presume that the matter can be resolved through a motion to dismiss or a motion for summary judgment.³⁴ An appeal of the judgment must go directly to the state’s Supreme Court, which is also instructed to hear the appeal “as expeditiously

³⁰ *Id.* Establishing nexus as a result of sales thresholds is commonly known as “economic nexus.”

³¹ S. 106, 91st Leg. Assemb. § 8 (S.D. 2016). Alabama and South Dakota are not the only states challenging *Quill*, however. Wyoming has passed a law, effective July 1, 2017, modeled after South Dakota’s statute that establishes economic nexus (sales delivered into the state exceeding \$100,000 or at least 200 separate transactions) and empowers the Department of Revenue to seek a declaratory judgement to confirm the validity of the statute under state and federal law. WYO. STAT. ANN. § 39-15-501 (2017). Vermont, Massachusetts, and Tennessee have also established economic nexus standards. VT. STAT. ANN. tit. 32, § 9701(9)(F) (2017) (also including a provision for notice requirements); TENN. COMP. R. & REGS. 1320-05-01-.129(2) (2017) (establishing an annual sales threshold of \$500,000 for economic nexus). Several other states have followed suit with related legislation; Mass. Dep’t of Revenue, Directive 17-1 (Apr. 3, 2017) (requiring registration for sellers with annual Massachusetts sales of \$500,000 in 100 or more transactions); *see also* H.B. 61, Gen. Assemb., Reg. Sess. (Ga. 2017); S.B. 620, 29th Leg (Haw. 2017); S.B. 545, 120th Gen. Assemb., Reg. Sess. (Ind. 2017); S.B. 2298, 65th Leg. Sess., Reg. Sess. (N.D. 2017).

³² S. 106, 91st Leg. Assemb. § 2 (S.D. 2016).

³³ *Id.*

³⁴ *Id.*

as possible.”³⁵ In case these procedural directives left any room for doubt, the law goes on to explicitly state that it was drafted to afford the Supreme Court of the United States an opportunity to reconsider the physical presence doctrine.³⁶

It did not take very long for the kill-*Quill* legislation to hatch controversies that could eventually become Supreme Court challenges to *Quill*. In South Dakota specifically, the governor’s signature on the bill had barely dried before the state sued multiple retailers.³⁷ On April 28, 2016, three days after the deadline for online retailers to register with the state, South Dakota brought suit against Newegg Inc., Overstock.com Inc., Systemax Inc. and Wayfair LLC.³⁸ Considering the timing of the suit and the relatively large size, number, and profile of the vendors included in the complaint, it is safe to assume that South Dakota wants this suit to be the case from which the Supreme Court overturns *Quill*.

These filings and the speed with which they can make their way up the South Dakota judiciary chain give renewed urgency to three questions: Will the U.S. Supreme Court hear a challenge to *Quill*? If so, how will the Court rule? If the physical presence standard is overturned, where will this leave online retailers?

³⁵ *Id.* § 4.

³⁶ *Id.* § 8.

³⁷ See Complaint at 13, *South Dakota v. Wayfair, Inc.*, No. 32 Civ. 16-000092 (6th Cir. Apr. 28, 2016). There is also litigation between Newegg.com and the State of Alabama. *Newegg, Inc. v. Dep’t of Revenue*, No. S. 16-613 (Ala. Tax Trib. appeal filed June 8, 2016). Due to the fast-track provisions of South Dakota’s law, Alabama’s legislation is not as likely to reach the Supreme Court first, but the case could still prove to be critical if it creates conflicting decisions in state supreme courts (thus increasing likelihood of certiorari in the U.S. Supreme Court).

³⁸ See Complaint at 13, *Wayfair, Inc.*, No. 32 Civ. 16-000092 (the law required vendors to register with the state by Apr. 25, 2016, and to commit to comply with the law by May 1). Systemax has since been dropped from the case as it began voluntarily collecting and remitting tax. Tripp Baltz, *Top E-Retailers, States Battle in Evolving Digital Sales Tax*, DAILY TAX REP., June 30, 2016, at J-1. The American Catalog Mailers Association and NetChoice have also filed suit against South Dakota asserting that the new law is unconstitutional. Complaint for Declaratory Judgment at 1–2, *Am. Catalog Mailers Ass’n v. Gerlach*, No. 32 Civ. 16-000096 (6th Cir. Apr. 29, 2016).

II. *QUILL* REDUX: OUTCOME OF A CHALLENGE TO *QUILL* BEFORE THE U.S. SUPREME COURT

A. *Would the Court Elect to Hear a Quill Challenge?*

In order for a case from a lower court to be heard by the Supreme Court, the Court must first grant a writ of certiorari.³⁹ Granting certiorari is not a right, but a matter of judicial discretion.⁴⁰ The cases typically selected by the court are those with issues that have been given conflicting treatment between state supreme courts or federal circuit courts, are of national significance, or could have precedential value.⁴¹ In order for the Court to grant certiorari, four justices must vote to hear the case.⁴²

In searching the current court roster for four certiorari votes, it may initially seem likely that the Court would vote to hear a *Quill* challenge. Justice Kennedy's vote seems like a sure bet, leaving only three to gain. Justice Thomas seems the next most likely vote as Thomas, the only other current member of the Court that was part of the *Quill* decision, was with Kennedy in joining Justice Scalia's *Quill* concurrence, which clarified that the three Justices did not so much endorse the merits of the physical presence standard, but acquiesced to it on the principle of stare decisis.⁴³ Assuming that Thomas still stands with Kennedy on *Quill* today, only two of the remaining seven justices—Alito, Breyer, Ginsburg, Roberts, Sotomayor, Kagan, and Gorsuch—would need to vote to hear the case.

³⁹ 28 U.S.C. §§ 1254, 1257 (2012).

⁴⁰ SUP. CT. R. 10.

⁴¹ *Id.*

⁴² See *Ferguson v. Moore-McCormack*, 352 U.S. 521, 529 (1957) (Frankfurter, J., dissenting) (explaining the origins of the “rule of four”). The “rule of four”—granting certiorari when four of nine justices vote to hear a case—is in place to prevent a majority from controlling the Court's docket. The rule of four likely still applies in periods where the Court is comprised of only eight justices, as it was for nearly a year during 2016 and 2017; there is no indication that the Court would grant certiorari based only on three votes while shorthanded. Richard L. Revesz & Pamela S. Karlan, *Nonmajority Rules and the Supreme Court*, 136 U. PA. L. REV. 1067 (1988).

⁴³ *Quill Corp. v. North Dakota*, 504 U.S. 298, 319–20 (1992) (Scalia, J., concurring) (Justices Thomas and Kennedy joined in this concurring opinion).

Thomas's stance on *Quill* from over twenty years ago, however, hardly guarantees that he also recognizes the need for a challenge to the decision in 2017.⁴⁴ He may still feel that stare decisis is as applicable now as it was in 1992. Additionally, it may be quite difficult to gain votes from the rest of the court. Based on prior petitions for certiorari in similar cases, the Court does not appear to have an appetite to hear challenges related to the physical presence rule. The Court has had many opportunities to hear cases related to the physical presence standard since *Quill*, but has denied them all, including a 2013 case weighing the constitutionality of New York's click-through nexus laws,⁴⁵ a 2011 case examining the boundaries of what constitutes physical presence and whether the physical presence standard applies to Washington's B&O tax,⁴⁶ and a litany of cases (some even with conflicting conclusions) considering whether the physical presence standard should apply to income/franchise taxes.⁴⁷

If the Court were truly searching for an opportunity to revisit the physical presence standard, then why has it passed on so many cases related to this issue? The prior cases all seem to provide sufficient grounds to reconsider the propriety of the physical presence standard. Additionally, if the Court did take a kill-*Quill* case after passing on so many prior physical presence cases, the Court would seem to be rewarding state lawmakers that draft unconstitutional laws simply because the lawmakers disagree with the current policy. One would think that the Court would be reluctant to go down this road.

Moreover, other justices have simply not signaled that they are interested in revisiting this issue. Justices' votes on whether to grant certiorari are not made public, so it is usually impossible to gauge the Court's interest in hearing an issue unless a justice voices his or her opinion on an issue, as

⁴⁴ It is worth noting, however, that Justice Thomas has expressed negative views towards dormant Commerce Clause restrictions in general. *See* *Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787, 1808 (2015) (Scalia, J., dissenting) (Justice Thomas joined in this dissent with Justice Scalia referring to the dormant Commerce Clause as "judicial fraud").

⁴⁵ *Overstock.com, Inc. v. N.Y. Dep't of Taxation & Fin.*, 20 N.Y.3d 586 (2013).

⁴⁶ *Lamtec Corp. v. Wash. Dep't of Revenue*, 246 P.3d 788 (Wash. 2011).

⁴⁷ *See* *KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d. 308 (Iowa 2010); *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999); *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993).

Justice Kennedy did in *Direct Marketing*. To the extent that other members of the Court shared Justice Kennedy's sentiment, they easily could have joined the concurrence.⁴⁸ The fact that no other Justice joined Justice Kennedy's concurrence is likely most telling, and it fits with the Court declining to revisit the physical presence issue in so many prior cases.

In *Direct Marketing*, Justice Kennedy called for the Court to find an "appropriate case" in which to reexamine *Quill*.⁴⁹ Given the Court's record of consistently denying certiorari on this issue and the fact that no other Justices signed onto Justice Kennedy's concurrence, it seems like the Court's hesitation to revisit the physical presence standard is not for want of an appropriate case, but because the Court simply lacks an appetite to hear this issue again. Based on this, it seems most likely that the Court will not hear a challenge to *Quill*. It appears that states such as South Dakota and Alabama prematurely accepted Justice Kennedy's invitation to litigate this issue, despite the fact that they had not received, and are not guaranteed, the three additional invitations that they need to make this a Supreme Court case.

B. How Would the Supreme Court Decide a Quill Challenge?

If, contrary to the prediction above, the Court decided to rule on a *Quill* challenge, would it decide to maintain the physical presence standard or eliminate it? Overturning prior Supreme Court precedent is not done lightly; the Court requires compelling reasons for diverting from stare decisis.⁵⁰ Based on his concurrence in *Direct Marketing*, it appears that Justice Kennedy believes these compelling reasons exist, pointing to states' collection and revenue shortfalls and the recent transformation of the online retail landscape.⁵¹ Specifically, Kennedy explained that "[w]hen the Court

⁴⁸ The exception is Justice Gorsuch, who was not appointed to the Court until Apr. 8, 2017.

⁴⁹ *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring).

⁵⁰ See *Lawrence v. Texas*, 539 U.S. 558, 577 (2003) (overturning prior Supreme Court precedent because there were "compelling reasons to do so"). The Court has also acknowledged that to overturn a prior decision it may ask whether the prior rule is unworkable practically, whether changing the rule would harm those who have relied on it, and whether facts or principles of law have developed to undermine the rule's justification. *Planned Parenthood v. Casey*, 505 U.S. 833, 854–55 (1992).

⁵¹ See *Direct Mktg. Ass'n*, 135 S. Ct. at 1135 (Kennedy, J., concurring). Specifically, Justice Kennedy cites studies estimating that California has only collected about four percent of use tax due on

decided *Quill*, mail-order sales in the United States totaled \$180 billion. But in 1992, the Internet was in its infancy. By 2008, e-commerce sales alone totaled \$3.16 trillion per year in the United States.”⁵²

While the growth of the online retail industry is undeniable, this “changing landscape” argument is not novel. In fact, it was considered when *Quill* was initially decided. The *Quill* court acknowledged the “‘wholesale changes’ in both the economy and the law” since the *Bellas Hess* decision, giving a nod to the “remarkable growth of the mail-order business ‘from a relatively inconsequential market niche’ in 1967 to a ‘goliath’ with annual sales that reached ‘the staggering figure of \$183.3 billion in 1989.’”⁵³ The *Quill* Court, however, did not believe that the growth of the mail-order industry necessitated a change in the physical presence standard.⁵⁴ In fact, the Court attributed the industry’s growth in part to the stability and consistency provided by a bright-line test.⁵⁵ It seems unlikely that trotting out this argument again would now be sufficient to justify a rejection of the physical presence standard.

More importantly, however, the Court’s main incentive to rely on stare decisis for this case is because the Court views this as an issue needing a legislative solution, not a judicial one. As the Court stated in *Quill*:

[T]he underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. Indeed, in recent years Congress has considered legislation that would “overrule” the *Bellas Hess* rule Accordingly, Congress is now free to decide whether, when, and to what

sales from out-of-state vendors, and that Colorado’s yearly loss of revenue in 2012 was around \$170 million. *Id.*

⁵² *Id.* (internal citations omitted).

⁵³ *Quill Corp. v. North Dakota*, 504 U.S. 298, 303 (1992) (quoting *State ex rel. Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 208–09, 213 (N.D. 1991)).

⁵⁴ *Id.* at 317–18.

⁵⁵ *See id.* at 316 (“Indeed, it is not unlikely that the mail-order industry’s dramatic growth over the last quarter century is due in part to the bright-line exemption from state taxation created in *Bellas Hess*.”).

extent the States may burden interstate mail-order concerns with a duty to collect use taxes.⁵⁶

Consistent with the *Quill* court, the newest member of the Supreme Court, Justice Neil Gorsuch, has offered recent support to the notion that overruling *Quill* should be a legislative endeavor.⁵⁷ In the most recent decision in the *Direct Marketing* controversy from the Tenth Circuit Court of Appeals, Justice Gorsuch remarked in a concurring opinion that the court was “duty-bound” to follow *Quill* “out of fidelity to our system of precedent whether or not we profess confidence in the decision itself.”⁵⁸ Further emphasizing the role of precedent, Justice Gorsuch explained that “judges distinguish themselves from politicians by the oath they take to apply the law as it is, not to reshape the law as they wish it to be,” and that “judges do not necessarily profess a conviction that every precedent is rightly decided, but they must and do profess a conviction that a justice system that failed to attach power to precedent . . . would hardly be worthy of the name.”⁵⁹ While it is noteworthy that Justice Gorsuch suggested that *Quill* and its underlying rationale may be set to “wash away with the tides of time,” his comments signal that he does not envision this happening via judicial action.⁶⁰

The sentiment shared by the *Quill* court and Justice Gorsuch—that Congress is better equipped to resolve issues related to the physical presence standard—is likely even more true today than it was when *Quill* was decided due to the numerous and growing number of legislative actions taken with respect to this issue. The most familiar of these actions are the Marketplace Fairness Act and the Remote Transactions Parity Act (previously the Main Street Fairness Act), which are the acts the Senate and House drafted, respectively, to address the tax collection issues faced by states. The acts generally authorize member states of the Streamlined Sales and Use Tax Agreement (SSUTA) to require all sellers not qualifying for a small-vendor

⁵⁶ *Id.* at 318 (internal citations and footnotes omitted).

⁵⁷ See *Direct Mktg. Ass’n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016). This case is a continuation of the controversy that included Justice Kennedy’s 2015 concurrence calling for the Supreme Court to revisit *Quill* and *Bellas Hess*. Before assuming his role as the 101st U.S. Supreme Court Justice, Justice Neil Gorsuch was a judge on the Tenth Circuit Court of Appeals, which ruled on the *Direct Marketing* cases.

⁵⁸ *Direct Mktg. Ass’n*, 814 F.3d at 1148 (Gorsuch, J., concurring).

⁵⁹ *Id.* at 1147–48.

⁶⁰ *Id.* at 1151.

exemption to collect and remit sales and use taxes, regardless of physical presence.⁶¹ Iterations of these acts have been introduced since 2010 and have received substantial levels of support, but have yet to become law.

Members of Congress have also proposed alternative methods of addressing state collection shortfalls caused by the physical presence rule. One proposal, dubbed the Online Sales Simplification Act, would require that states switch from a destination-based sourcing approach for sales tax collection to an origin-based sourcing approach (meaning that sales tax would have to be collected based on the location of the seller instead of the purchaser).⁶² Another bill, the No Regulation Without Representation Act, would take the opposite approach of the Marketplace Fairness and Remote Transaction Acts, essentially proposing to codify the physical presence standard.⁶³ These two acts, however, have not garnered the same degree of support as the Marketplace Fairness and Remote Transaction Acts.⁶⁴

State legislatures themselves also appear capable of overcoming tax collection limitations caused by the physical presence standard (without drafting laws that directly conflict with Supreme Court precedent). Specifically, states could simply implement origin-based sourcing on sales from their states, independent of any federal legislation. Several states currently apply origin-based sourcing to narrow subsets of sales, usually sales by florists.⁶⁵ Theoretically, states could change their sourcing methods to apply origin-based sourcing to all online transactions. At least one state's

⁶¹ See S. 698, 114th Cong. (2015); H.R. 2775, 114th Cong. (2015).

⁶² Chris Marr, *Dim Outlook for Bill Barring States' Online Sales Tax Push*, DAILY TAX REP., July 19, 2016, at G-4. The Online Sales Simplification Act has been proposed by House Judiciary Committee Chairman Robert Goodlatte (R-Va.) in a discussion draft, but has yet to be formally introduced. See CHAIRMAN OF H. COMM. ON THE JUDICIARY, 114th CONG. DISCUSSION DRAFT OF THE ONLINE SALES SIMPLIFICATION ACT (2016).

⁶³ H.R. 5893, 114th Cong. (2016).

⁶⁴ Andrew M. Ballard, *Streamlined Sales Tax Group Seeks Details on E-Retailer Bills*, DAILY TAX REP., July 29, 2016, at H-3.

⁶⁵ See, e.g., FLA. STAT. § 212.05(1)(l) (2016); 68 OKLA. STAT. ANN. § 1354(A)(19) (2016); WASH. ADMIN. CODE § 82.32.730(7)(d) (2016).

Supreme Court has found origin-based sourcing laws to be constitutional under the dormant Commerce Clause.⁶⁶

Another state-level solution involves focusing on the collection of use tax from purchasers rather than sales tax collection by sellers. Multiple states, including Colorado, Oklahoma, Louisiana, and Vermont have enacted notice requirements.⁶⁷ Instead of requiring out-of-state vendors to collect and remit tax on sales to customers in these states, the notice requirements generally require the out-of-state vendors to provide notice to the customers that their purchases are subject to the state's use tax and to provide the state with a detailed list of in-state customers that purchased goods from the vendor.⁶⁸ Although the constitutionality of these laws has not been litigated extensively, the latest decision from the Tenth Circuit Court of Appeals is that Colorado's notice requirement is constitutional.⁶⁹

In short, the Court has clearly indicated that it views issues created by the physical presence standard as a problem in need of a legislative solution. Considering the myriad legislative solutions available at the state and federal level currently being explored and implemented, there is little reason to think that the Court would now intervene and craft a new judicial mandate on the issue. Accordingly, if the Court were to hear a *Quill* challenge, the Court would likely cling to stare decisis as it did in *Quill*. Reason would likely dictate, though, that if the court were likely to reach the same conclusion on the same basis for a *Quill* challenge as it did in *Quill*, the Court would likely decline to hear the case in the first place.

⁶⁶ See Fla. Dep't of Revenue v. Am. Bus. USA Corp., 190 S.3d 906 (Fla. 2016) (holding that a statute requiring origin-based sourcing for sales by florists was constitutional under the *Complete Auto Transit* dormant Commerce Clause test).

⁶⁷ See COLO. REV. STAT. § 39-21-112(3.5)(c)(I) (2016); LA. STAT. ANN. § 47:309.1 (2016); OKLA. STAT. tit. 68, § 1406.2(A) (2016); VT. STAT. ANN. tit. 32, § 9712 (2016). Arkansas and Georgia have also introduced recent legislation relating to notice requirements. H.B. 1388, 91st Gen. Assemb., Reg. Sess. (Ark. 2017), H.B. 61, Gen. Assemb., Reg. Sess. (Ga. 2017).

⁶⁸ See *supra* note 67.

⁶⁹ See Direct Mktg. Ass'n v. Brohl, 814 F.3d 1129, 1138 (10th Cir. 2016) (reasoning that the physical presence standard does not apply to Colorado's notice requirements because the holding in *Quill* was limited to the application of sales and use taxes).

C. What Would a Reversal of Quill Mean for Retailers?

Notwithstanding the above analysis, the possibility exists that the Supreme Court could grant certiorari in a kill-*Quill* case and could rule to eliminate the physical presence standard. This possibility presents online retailers with a dilemma: whether to comply with a law that, under current jurisprudence, is facially unconstitutional, or to defy the law and risk sanctions by the state. Retailers must weigh many factors in resolving this dilemma, perhaps the chief of which is the potential exposure that could result from noncompliance. Specifically, what if a retailer lacking physical presence in South Dakota does not collect tax, but the Court ultimately upholds the state's law and eliminates the physical presence standard? Would the state only be able to impose collection obligations prospectively from the date that *Quill* is overturned and the physical presence rule abandoned? Or could the state apply its statute retroactively from the date of the Court's decision and assess taxes going back to the date the kill-*Quill* law was enacted? Depending on the answer, the potential exposure from noncompliance could be nominal or it could be devastating.

In the context of civil law, whether a constitutional decision should be applied retroactively depends on the outcome of a multifactor test established in *Chevron Oil Co. v. Huson*.⁷⁰ Under the *Chevron Oil* test, a court will consider three factors that weigh in favor of not applying the overruling decision retroactively: (1) if the decision establishes a new principle of law, such as overruling clear past precedent on which litigants may have relied; (2) if the decision in question does not require retroactive application to further its purpose and effect; and (3) if the retroactive application of the decision will create an inequitable result.⁷¹

In at least one instance, the Supreme Court has overruled prior precedent regarding the constitutionality of a tax under the dormant Commerce Clause and held that its new ruling *did not* apply retroactively under the *Chevron Oil* test.⁷² In *American Trucking Association v. Smith*, taxpayers requested a

⁷⁰ *Am. Trucking Ass'n v. Smith*, 496 U.S. 167, 177–79 (1990).

⁷¹ *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106–07 (1971).

⁷² *See Am. Trucking Ass'n*, 496 U.S. at 188.

refund of an Arkansas flat highway tax, on the basis that the tax was unconstitutional.⁷³ The Supreme Court, in overruling prior precedent relating to flat taxes, caused the Arkansas tax to be struck down.⁷⁴ The question then became whether the taxpayers were entitled to a refund for taxes that were paid prior to the point at which the Supreme Court found the tax to be unconstitutional.⁷⁵ The Court declined to apply the decision retroactively (denying refunds to taxpayers that paid the tax) based on the *Chevron Oil* factors, explaining that its new ruling created a new principle of law, and that retroactive application would create an inequitable result for the state since the state was justified in relying on the then-current precedents of the Court.⁷⁶

American Trucking strongly suggests that a decision overruling precedent on the constitutionality of a tax under the dormant Commerce Clause should not be applied retroactively. As with *American Trucking*, reversal of precedent with *Quill* would create a new principle of law and would arguably create an inequitable result by whipsawing retailers that are relying on current Supreme Court precedent. Retailers relying on *American Trucking*, however, should note that it may not necessarily control a reversal of the physical presence standard, as only four Justices joined the opinion regarding application of the *Chevron Oil* test.⁷⁷ Moreover, in the limited instances where a previously unconstitutional tax has been declared to be constitutional, state courts have been inconsistent in deciding whether to apply the tax retroactively.⁷⁸ Overall, though, when considering that the Court is not likely to hear a *Quill* challenge, that the Court is not likely to overturn the physical presence standard, and that *American Trucking* likely

⁷³ *Id.* at 172.

⁷⁴ *Id.* The Court initially found flat taxes to be constitutional under *Aero Mayflower Transit Co. v. Georgia Public Service Commission*, 295 U.S. 285 (1935), and its progeny, but subsequently overruled this decision by finding Pennsylvania's flat highway tax to be unconstitutional in *American Trucking Association v. Scheiner*, 483 U.S. 266 (1987). *Am. Trucking Ass'n*, 496 U.S. at 179–80.

⁷⁵ *Am. Trucking Ass'n*, 496 U.S. at 174.

⁷⁶ *Id.* at 179–82, 188.

⁷⁷ Justice Scalia concurred in the judgment with Justices O'Connor, Rehnquist, White, and Kennedy, but did not agree with the reasoning of the judgment. *Id.* at 167.

⁷⁸ See, e.g., *Mercantile Nat'l Bank v. Lander*, 109 F. 21 (C.C.D. Ohio 1901) (ruling that a reversal in precedent did not enable a county to apply tax retroactively); *People ex rel. Rice v. Graves*, 242 A.D. 128 (N.Y. App. Div. 1934) (allowing the retroactive application of tax after a reversal of precedent).

precludes retroactive application of the kill-*Quill* law, it would seem that the potential exposure for noncompliance with the new laws is relatively low.⁷⁹

III. PRACTICAL IMPLICATIONS FOR ONLINE RETAILERS

Without a Supreme Court ruling overturning the physical presence standard, online retailers will likely have to adapt to an increasingly confusing and complex patchwork of state and local sales and use tax compliance requirements. Although increasing state revenue shortfalls and controversy over nexus and notice laws have vastly increased awareness around the issue, federal legislation related to sales and use tax collection has been discussed for several years without gaining real traction. Additionally, there is currently more dispute about how a federal law should address the issue than ever before, and legislators may be tempted to sit on the sidelines to see whether the courts take action on the kill-*Quill* challenges. As a result, retailers likely cannot afford to stand pat and wait for a uniform federal solution in the short term. Instead, the immediate term action is to monitor and adapt to state legislation.

New state legislation in the near term is all but guaranteed, with at least forty-two related bills in sixteen states being introduced in 2016.⁸⁰ Based on the 2016 state bills that were introduced, future laws will likely continue to be split between lowered nexus thresholds and increased notice/reporting requirements.⁸¹ The fact that the various nexus and notice bills differ in their details will further contribute to the patchwork nature of future compliance.⁸²

⁷⁹ This is in terms of tax, penalty, and interest that may be assessed. These costs clearly do not contemplate potential costs of litigation.

⁸⁰ Liz Malm, *Four States Have Enacted Sales Tax Nexus Legislation This Year, with Dozens of Other Bills Still Active*, MULTISTATE INSIDER (May 10, 2016), <https://www.multistate.com/insider/2016/05/three-states-have-enacted-sales-tax-nexus-legislation-this-year-with-dozens-of-other-bills-still-active/>.

⁸¹ For example, Kansas and Utah both introduced bills that would have imposed notice requirements, while Connecticut and Minnesota both introduced bills that would have lowered the state's nexus threshold below the physical presence standard. *See* S. 448, 2016 Reg. Sess. (Conn. 2016); H. 2603, 2016 Sess. (Kan. 2016); H. 3787, 89th Legis., Reg. Sess. (Minn. 2016); S. 65, 2016 Gen. Sess. (Utah 2016).

⁸² For instance, Alabama's economic nexus rule imposes a filing requirement when in-state annual sales exceed \$250,000. ALA. ADMIN. CODE r. 810-6-2-.90.03 (2016). Minnesota's bill used \$200,000 as

Eventually, a kill-*Quill* challenge will likely make its way through the lower courts and the Supreme Court will be asked to hear the case. If, as predicted here, the Supreme Court either declines to hear the case or declines to abrogate the physical presence standard, there are two main changes that will likely result. First, states that enacted nexus thresholds below the physical presence standard will have to reverse course (presumably, under stare decisis lower courts will rule that the statutes are unconstitutional, being squarely at odds with the *Quill* holding).⁸³ In order to re-recoup the lost tax revenues, these states will likely enact notice requirements and/or more aggressive Amazon laws to replace their no-physical-presence collection laws. Accordingly, online retailers should be prepared to comply with many new state notice requirements.

Second, with the judicial solution officially being removed from the table, this will likely be the breaking point at which the clamor for federal legislation becomes overwhelming. Congress will predictably be forced to finally decide on and pass a uniform standard for states to impose sales and use tax collection obligations on out-of-state retailers. Although South Dakota's nexus law contains fast-track provisions and suits are already pending, it could still be years before we reach this point. Accordingly, in the meantime, online retailers will be forced to monitor the evolving state

a threshold. H. 3787, 89th Legis., Reg. Sess. (Minn. 2016). South Dakota's law uses \$100,000. S. 106, 91st Leg. Assemb. (S.D. 2016). Louisiana's notice requirement applies to sellers with Louisiana gross receipts exceeding \$50,000. LA. STAT. ANN. § 47:309.1(B)(2) (effective July 1, 2017). Whereas Oklahoma's notice requirement does not have a minimum sales threshold. OKLA. STAT. tit. 68, § 1406.2(A) (2016).

⁸³ This assumes that lower courts do not uphold the statutes in an "anticipatory overruling," which is a decision by a lower court contravening Supreme Court precedent when the lower court believes that the Supreme Court will overturn its own precedent. Anticipatory rulings are rare, but do occur. Margaret N. Kniffin, *Overruling Supreme Court Precedents: Anticipatory Action by United States Courts of Appeals*, 51 FORDHAM L. REV. 53 (1982). In fact, this is exactly what the North Dakota Supreme Court did to reach its opinion in the *Quill* case (reasoning that "Quill in effect asks us to accept the notion that the United States Supreme Court will abandon its common sense and experience at the courthouse door and ignore the tremendous social, economic, commercial, and legal innovations since 1967, and blindly apply an obsolescent precedent," *State ex rel. Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 208 (N.D. 1991)). As pointed out by Justice Scalia in *Quill*, however, the Supreme Court does not welcome anticipatory overrulings by lower courts. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 321 (1992) (Scalia, J., concurring) (quoting *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989)) ("We have recently told lower courts that 'if a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [the lower court] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.' It is strangely incompatible with this to demand that private parties anticipate our overrulings." (internal citations omitted)).

requirements and make operational decisions regarding how best to comply with the patchwork of compliance requirements.

