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## Supreme Court Rules that Online Sellers Can Be Required to Collect Sales Tax

By: Ivan H. Golden

Online retailers and others who sell goods or services into a state can be required to collect sales tax, even if they lack a physical presence in the state, the Supreme Court ruled on Thursday.

The Supreme Court's decision in *South Dakota v. Wayfair* overrules the "physical presence" requirement – a cornerstone of state taxation for more than 50 years – and has the potential to affect nearly every business that sells goods or services to customers across state lines.

Under the physical presence rule, a state could not force a business to pay sales tax when it made sales to state residents unless the business had a physical presence – such as an employee, office, warehouse, or inventory – in the state. But the Supreme Court said on Thursday that the rule was "artificial in its entirety," overruling two earlier precedents.

For a generation, online retailers (and mail-order sellers before them) were able to benefit from the physical presence rule by not collecting sales tax – and thus offering their products at lower prices – on sales into states where they lacked a physical presence. Indeed, some online retailers purposefully planned their activities to minimize their sales tax collection responsibilities. That led to complaints from brick-and-mortar businesses, which could not avoid collecting tax, and states themselves, which saw their sales tax revenues plummet. The Supreme Court in *Wayfair* went so far as to call the physical presence requirement a "judicially created tax shelter."

The *Wayfair* case involved a South Dakota statute that requires out-of-state sellers to collect sales tax— regardless of the seller's physical presence in South Dakota – if the seller, on an annual basis, either delivered more than \$100,000 of goods or services into the state or engaged in 200 or more separate transactions with state residents. The statute clearly violated the physical presence requirement. But in siding with South Dakota, the Supreme Court explained that the rule had become an anachronism: "Each year, the physical presence rule becomes further removed from economic reality and results in significant revenue losses to the States."

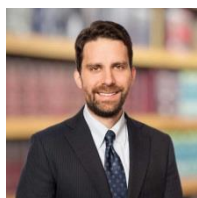
The Court's decision is likely to have profound effects on online sales and interstate sales generally. Those states that have not done so already are likely to enact statutes similar to the South Dakota law. Companies that sell goods or services in multiple states but collect tax in only one or a few, based on where they have a physical presence, must begin collecting tax wherever they make more than a *de minimis* amount of sales. At the same time, firms that have scrupulously avoided creating a physical presence in a state may find there is no longer

an impediment to establishing an office, opening a warehouse, or sending employees to different states to be closer to clients and customers. And consumers are likely to find fewer outlets where they can purchase goods and services tax-free (under existing law, consumers who purchase taxable items and are not charged sales tax are supposed to self-assess use tax, but compliance with use tax requirements is notoriously low).

One unanswered question in *Wayfair* is the amount of sales or the number of transactions a retailer must make before a state can require the retailer to collect sales tax. The Supreme Court noted approvingly that the South Dakota statute requires sales of more than \$100,000 of goods or services or 200 or more separate transactions before its requirements apply to out-of-state sellers; that the law does not apply retroactively; and that South Dakota is one of more than 20 states that has adopted the Streamlined Sales and Use Tax Agreement, which simplifies state sales tax laws and procedures to make it easier for businesses to comply.

The retailers in *Wayfair*—Wayfair, Inc., Overstock.com, Inc., and Newegg, Inc.—are all major online sellers with billions in revenues and the means to comply with the South Dakota statute (and similar rules in other states). But there are other, smaller retailers who may be at or just over the threshold and for whom compliance may represent a more significant burden.

[If you would like additional information about the *Wayfair* case, please contact any of the professionals listed below:



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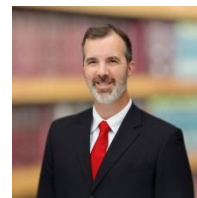
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