



State & Local Tax Advisory ■

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The Supreme Court Weighs a New State Tax Nexus Standard, Again

The *South Dakota v. Wayfair Inc.*¹ [oral argument](#) was lively, to say the least. The U.S. Supreme Court Justices pummeled each of the three advocates—South Dakota Attorney General Marty Jackley, U.S. Deputy Solicitor General Malcolm Stewart, and Wayfair’s counsel George Isaacson—with questions and commented on issues they will consider in evaluating whether to overturn *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), or leave the ruling intact and continue to defer to Congress to formulate an alternative—if any—to the existing Commerce Clause “substantial nexus” standard of physical presence for remote sellers. Overall, the Justices’ comments indicated that the Court is divided about its appropriate response to the South Dakota law, but based on the arguments, a ruling to affirm the status quo and hold for the taxpayers would not be surprising.

Background

This case’s origins are found in the South Dakota legislature’s reaction to Justice Kennedy’s concurrence in the *Direct Marketing Association v. Brohl* case, which the Supreme Court decided in 2015. Justice Kennedy authored a concurring opinion in which he contended that modern e-commerce rendered the *Quill* physical-presence standard unworkable and should be revisited.

Responding to this invitation of sorts, South Dakota passed legislation (S.B. 26) shortly thereafter to challenge the physical presence standard affirmed in *Quill* and to replace it with an “economic nexus” standard under which out-of-state sellers with \$100,000 in sales into the state or 200 sales to in-state customers are required to collect and remit use tax on those sales. Other states followed suit by enacting their own versions of economic-presence nexus statutes targeted at remote sellers of taxable goods and services. South Dakota’s thumb in the eye of *Quill* in turn invited immediate challenge by Wayfair and other remote sellers, and the fast-track appeal mechanism included in South Dakota’s bill allowed the case to reach the Court quickly. Justice Kennedy invited the case, but—based on yesterday’s argument—it is not clear that the entire Court believes that the intervening years are cause to change the *Quill* status quo.

¹ Alston & Bird partner Clark Calhoun represented Americans for Tax Reform in its [amicus curiae brief](#) in this case.

Major Themes of Oral Argument

Each of the advocates was held to account for his client's positions and the support outlined in the parties' briefs. Justice Breyer repeatedly pressed both sides to articulate facts that could inform the Court's decision whether to overturn *Quill*, and he highlighted a difficulty created by the absence of a factual record in this case: "[T]he reason I'm asking like this is because I read through these briefs. When I read your briefs, I thought absolutely right. And then I read through the other briefs, and I thought absolutely right. And you cannot both be absolutely right." He asked questions that other justices homed in on, namely:

What is the real-dollar impact of this issue, and how should the Court determine and weigh the benefits and burdens of keeping the physical-presence standard vs. eliminating it and replacing it with South Dakota's enacted standard?

Justice Breyer interjected that "you [each] have wildly different estimates of costs, revenues, and what states are losing or not." On the other hand, both sides cited the same U.S. Government Accountability Office (GAO) study to support their positions during the argument, which may further confuse the matter for the Court. Chief Justice Roberts noted his impression that the problem complained of by South Dakota and the other states (i.e., revenue loss from taxes that are not collected) was a "diminishing problem," and that pointed toward retaining the physical-presence standard (and allowing Congress to supply a new standard, if any). The Justices generally recognized that the physical-presence standard causes harm to various constituencies, but a number of them expressed concern that replacing the long-standing rule would unleash new and unpredictable harms should the Court change the status quo instead of continuing to defer to Congress. On the other hand, Justice Gorsuch in particular seemed more concerned that the physical-presence standard itself is warping the debate and should be eliminated.

How do we deal with the "really tough practical decisions" such as retroactivity?

A number of Justices expressed concerns about the Court's ability to manage potential retroactive assessments against taxpayers and to prescribe an administrable standard should *Quill* be reversed. Justice Sotomayor quickly voiced those concerns, as she raised questions to the South Dakota attorney general almost as soon as he began speaking. The retroactivity issue clearly concerned several Justices, both as a theoretical and practical matter. While Justice Ginsburg suggested that if the Court overturns *Quill*, Congress could address retroactivity itself, the deputy solicitor general conceded that it would *not* be unconstitutional for the states to apply the Court's proposed ruling (overturning *Quill*) retroactively.

The attorneys for South Dakota and the United States sought to allay those concerns by noting the states' incentives to administer any ruling fairly and constitutionally, but Justice Alito expressed skepticism that all states would be properly restrained by such concerns. The government attorneys also appeared to undermine somewhat the specific threshold that the South Dakota legislature had crafted for the Court's consideration, as both attorneys contended that a threshold of a *single sale into a state* could be constitutionally sufficient. Given the practical concerns raised by a number of Justices about the uncertainty of what would happen in the event of a reversal, the ambiguity over whether the South Dakota law would establish a new constitutional minimum is an additional obstacle to a ruling in favor of the states.

Another important theme explored in the oral argument is the potential period of chaos that could ensue in the aftermath of a decision to overturn *Quill*. Both Isaacson and Justice Sotomayor expressed concern that if *Quill* is overturned, the sales tax landscape could become a “Wild West”; and Isaacson explained that tax collection software is no “silver bullet” given the many issues that software does not automate (e.g., record retention, filing of reports, and audit management). On the other hand, the state emphasized that its own regime imposes the least imaginable burdens on sellers and should not be held up as an exemplar of the potential parade of horrors, post-overturn of *Quill*.

Analysis

While it is impossible to draw any firm conclusions about the likely result in the case from the oral argument, the proceedings demonstrated clear divisions among the Justices regarding the proper nexus standard and how the Court should view its role in creating—and resolving—the tax collection issues that the Court’s physical-presence rule has engendered. We expect the Justices will carefully consider the following as they work toward their decision:

- Are the Justices more persuaded by the conflicting facts and figures presented by the taxpayers or the government? They are more likely to hew to the long-standing physical-presence rule if they are not clearly persuaded by the state’s insistence that software has largely alleviated the high costs and burdens of nationwide collection.
- Does each Justice think that the alleged “harms” of the physical-presence test (to states’ budgets and to “Main Street” businesses at a disadvantage compared to remote sellers who do not collect tax) outweigh the potential harms of throwing out that standard (e.g., retroactive assessments and chaotic, inconsistent application across the states)? Again, they are more likely to hew to the status quo unless they believe that the physical-presence rule’s harms clearly call for the Court’s intervention (rather than allowing the rule to stand unless and until Congress substitutes a new one).
- Is the Court comfortable affirming South Dakota’s new thresholds (and preempting Congress’s opportunity), or perhaps even prescribing some other standard? Just as Justice Scalia expressed in *Quill* in 1992, Congress’s authority to prescribe a new standard has “special force” and dictates caution on the Court’s behalf; that is not ironclad, but appears to continue to guide some of the current Justices’ thinking in 2018.
- Does the Court believe the state’s contention that the existence of the physical-presence standard impedes congressional action in a way that a different threshold (e.g., the South Dakota rule, or no rule at all) would not? South Dakota has repeatedly insisted that the physical-presence rule is warping Congress’s willingness to act; the Court’s decision may turn on whether at least five Justices agree.

Please contact us with any questions regarding this case, how it may affect your business, and/or other related state tax developments.

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