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# The Wake of Wayfair: Addressing State Taxation Issues after South Dakota v. Wayfair.


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**Cover Page Footnote**

Juris Doctor candidate, Belmont University College of Law, 2019; B.A. Middle Tennessee State University, 2016. Sincerest thanks to Professor Jeffrey Usman for his guidance and input throughout the drafting process, as well as to Professor Charlie Trost for sharing his time, experience, and perspective on the issues discussed herein. Additionally, this paper would not have been possible without the diligent work of Sara, Ashley, Sarah, Tenia, Austin, and Trey in preparing this submission for publication. My gratitude to each and every one of you, and to the teachers, mentors, and scholars who have inspired me along the way. Dedicated to Sandra Carlene Walker.

# THE WAKE OF *WAYFAIR*: ADDRESSING STATE TAXATION ISSUES AFTER *SOUTH DAKOTA V. WAYFAIR*.

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## INTRODUCTION

The internet has become an integral part of how Americans conduct their daily lives. Today, approximately nine of every ten American adults

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use the internet to some extent,[1] and that trend appears to have remained on the rise since the introduction of the world wide web on August 6, 1991.[2] While the list of uses for this technology can seem as expansive as its user base, there are several activities that are most popular with the American people. Among these popular activities is, some would say unsurprisingly, shopping.[3]

The rise of internet retail sales, also known as e-commerce, may be a natural response to advancing technologies, but it also heralds a decline in more traditional forms of retail. Specifically, physical storefronts, also known as brick-and-mortar stores, have seen a decrease in traffic, which has negative implications for sales tax revenue and the states that rely on it.[4] As traditional retail locations close their doors, tax revenue growth slows.[5] In order to combat these declining growth rates, states have begun seeking alternatives to limit their dependence on the physical storefront. E-commerce is one such alternative, which has the potential to bolster states' tax revenue without running afoul of constitutional or market protections on internet retail sales. However, taxing e-commerce raises a number of complications—most notably, how far states may extend their taxing authority to retailers who are not, either physically or functionally, contained within the territorial bounds of the state. If states reach too far, they risk running afoul of constitutional protections to interstate commerce and hampering the very industry they seek to access. If they do not reach far enough, states risk continued declines in sales tax revenue, upon which they heavily rely. Ultimately, states must strive to strike a balance that captures the benefits of e-commerce taxation while respecting the bounds of their own authority and the needs of the industry.

In support of this conclusion, this note begins in Section I by examining the shift toward e-commerce and its impact on state tax revenue. Next, Section II explores internet retail jurisprudence and the inception and dominion of the physical presence requirement. As of June 21, 2018, however, that requirement has been laid to rest, and Section III addresses the

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1. *Internet/Broadband Fact Sheet,* PEW RESEARCH CTR. (Feb. 5, 2018), http://www.pewinternet.org/fact-sheet/internet-broadband/.

2. Nick Carbone, *Not So High-Tech Anymore: The First Website Ever Celebrates Its 20th Birthday*, TIME (Aug. 6, 2011), http://newsfeed.time.com/2011/08/06/the-first-website-ever-celebrates-its-20th-birthday/.

3. Aaron Smith & Monica Anderson, *Online Shopping and E-Commerce*, PEW RESEARCH CTR. (Dec. 19, 2016), http://www.pewinternet.org/2016/12/19/online-shopping-and-e-commerce/.

4. *See* Alana Semuels, *All the Ways Retail's Decline Could Hurt American Towns*, THE ATLANTIC (May 23, 2017), https://www.theatlantic.com/business/archive/2017/05/retail-sales-tax-revenue/527697/.

5. *Id.*

outcome and effects of *South Dakota v. Wayfair, Inc*.[6] Section IV describes the approaches states are currently taking to e-commerce taxation and considers whether those approaches may continue to be valid under the new rule. Finally, noting still-unresolved issues in e-commerce taxation, Section V offers a model provision for imposing sales and use tax on internet retail that would respect continuing constitutional protections while still allowing states to take full advantage of a rapidly-growing revenue source.

## I. THE RISE OF INTERNET RETAIL AND THE CURRENT SALES AND USE TAXATION SYSTEM

Nearly 80% of adults in the United States are online shoppers as of 2016, which marks a considerable jump from the roughly 22% of American adults who reported making online purchases in 2000.[7] Additionally, over half of those who reported making online purchases make at least several purchases per month, and a majority of Americans will not buy from stores without checking prices online first.[8] There are many theories that purport to explain this growth: the convenience of online retail,[9] for example, or consumers' desire to compare and review products before purchasing.[10]

Whatever the cause, the fact remains that internet retail sales are on the rise. To illustrate this point, e-commerce sales in the first quarter of 2007 accounted for only 3.2% of total retail sales in the United States, or $31.5 billion.[11] By contrast, in the first quarter of 2017, e-commerce sales were $105.7 billion, or 8.5% of total retail sales.[12] That ten-year period saw a significant leap in the productivity of online retail; the percentage of e-commerce sales in the market more than doubled, and the total value of e-

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6. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

7. Smith & Anderson, *supra* note 3.

8. "Roughly one-in-five (21%) [adults in the U.S.] say they would buy from stores without checking prices online[.]" *Id.*

9. Seventy-two percent of weekly online shoppers value the ability to buy online without making a trip to the store. Aaron Smith & Monica Anderson, *Online shopping and purchasing preferences*, PEW RESEARCH CTR. (Dec. 19, 2016), http://www.pewinternet.org/2016/12/19/online-shopping-and-purchasing-preferences/.

10. "Americans take a number of factors into consideration when shopping for something that they haven't purchased in the past – especially the ability to compare prices from multiple sellers and to ask questions about what they are buying." *Id.* "Better selection" has also been identified as a leading reason that shoppers choose online retail. Barbara Thau, *New Study Reveals Why Consumers Really Shop Online (Surprise: It Isn't Low Prices)*, FORBES (Oct. 8, 2013), https://www.forbes.com/sites/barbarathau/2013/10/08/why-consumers-really-shop-online/#34b702b3c17a.

11. U.S. DEP'T OF COMMERCE, QUARTERLY RETAIL E-COMMERCE SALES 1ST QUARTER 2007 (2007), https://www.census.gov/mrts/www/data/pdf/07Q1.pdf.

12. U.S. DEP'T OF COMMERCE, QUARTERLY RETAIL E-COMMERCE SALES 1ST QUARTER 2017 (2017), https://www2.census.gov/retail/releases/historical/ecomm/17q1.pdf.

commerce sales more than tripled.[13] These macro-scale trends can be seen at a micro level as well. For example, North American sales for the well-known online retailer Amazon saw a 400% increase between 2010 and 2016, rocketing from $16 billion to $80 billion.[14] This growth has culminated in an estimated $123.7 billion spent on e-commerce in the first quarter of 2018.[15]

While this trend is good news for the e-commerce market, its impact on traditional retail may not be so positive. Brick-and-mortar stores have seen continuing declines in traffic "[a]cross just about every sector and virtually every time period."[16] Despite numerous positive markers for the retail economy—wage growth is on a post-recession high even in America's lower- and middle-class families,[17] GDP is on the rise, and overall retail spending is up[18]—many brick-and-mortar stores are struggling to stay afloat.[19] Nine physical-store retailers filed for bankruptcy within the first three months of 2017, placing 2017 on track to have the highest rate of Chapter 11 filings for physical-store retailers since the Great Recession of 2008.[20] Large retail chains like J.C. Penney and Macy's have announced hundreds of store closures, and mall visits dropped 50% from 2010 to 2013 and have continued to fall each year thereafter.[21] As online retailers expand,

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13. For a more in-depth look at the progression of e-commerce sales, the United States Census Bureau provides a "Time Series" of e-commerce reports that charts the total and e-commerce sales (adjusted quarterly for seasonal variations, but not for price changes) of each fiscal quarter, issuing from the fourth quarter of 1999 onward. *See Monthly & Annual Retail Trade*, U.S. CENSUS BUREAU (June 29, 2017), https://www.census.gov/retail/index.html#ecommerce (follow the "Adjusted Sales" hyperlink by the Time Series).

14. Derek Thompson, *What in the World is Causing the Retail Meltdown of 2017?*, THE ATLANTIC (Apr. 10, 2017), https://www.theatlantic.com/business/archive/2017/04/retail-meltdown-of-2017/522384/.

15. In all, e-commerce accounted for nearly one-tenth of total sales in the United States during the first quarter of 2018. U.S. DEP'T OF COMMERCE, QUARTERLY RETAIL E-COMMERCE SALES 1ST QUARTER 2018 (2018), https://www2.census.gov/retail/releases/historical/ecomm/18q1.pdf.

16. Steve Dennis, *What if Retail Traffic Declines Last Forever*?, FORBES (Feb. 16, 2017, 10:47 AM), https://www.forbes.com/sites/stevendennis/2017/02/16/what-if-retail-traffic-declines-last-forever/#667101d962c0.

17. Derek Thompson, *The Most Underrated Story about the U.S. Economy*, THE ATLANTIC (Mar. 9, 2017), https://www.theatlantic.com/business/archive/2017/03/wages-rising/519114/.

18. Thompson, *supra* note 14.

19. *See* Krystina Gustafson, *Retail Bankruptcies March Toward Post-Recession High*, CNBC (Mar. 31, 2017, 6:54 PM), https://www.cnbc.com/2017/03/31/retail-bankruptcies-march-toward-post-recession-high.html.

20. *Id.*

21. Thompson, *supra* note 14.

shopping in brick-and-mortar stores declines.[22] While it would be an oversimplification of a complex issue to say that e-commerce is wholly responsible for the downfall of the brick-and-mortar, the former certainly appears to have stolen some of the latter's financial thunder.[23]

Some companies, however, are adapting to the change. After integrating its physical storefronts with new online platforms, the home improvement retail chain Home Depot saw a 6% increase in sales for its U.S. stores and generated $90 billion in annual revenue in 2016, all without opening any new storefronts in the last three years.[24] Its online sales revenues rose from 1% in 2011 to 5.6% in 2016.[25] Walmart is another example, announcing a whopping 63% growth in its e-commerce sales in the second fiscal quarter of 2017, as well as an overall rise in sales.[26] Its announcement came in the year following Walmart's overhaul of its e-commerce strategy, which included the $3.3 billion purchase of Jet, a successful online bulk retailer.[27] Both companies have developed ways to expand their internet retail presence to take advantage of the online marketplace, and both companies have experienced concurrent increases in overall sales.

The lesson to be learned from these examples is among the most fundamental of business principles: adapt to survive. And this principle extends not only to companies, but to state governments as well. Because state governments derive a large amount of their tax revenue from sales and use taxes, they are in many ways dependent upon the retail market for income.[28] In the first fiscal quarter of 2017, sales and gross receipts taxes accounted for $72.4 billion, or 31.4% of total tax revenue.[29] This marked an increase of 2.3% from the same quarter in 2016,[30] indicating an increased reliance on sales tax for state tax revenue. That reliance is even higher in some regions of the United States. In the South, for instance, sales and gross

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22. *Id.* (identifying the "rise in e-commerce" as a contributor to the decline of brick and mortar shopping).

23. *Id.*

24. *Here's How Home Depot's E-Commerce Strategy is Driving Growth,* FORBES (Feb. 15, 2017, 1:41 PM), https://www.forbes.com/sites/greatspeculations/2017/02/15/heres-how-home-depots-e-commerce-strategy-is-driving-growth/#41a5650e9b62.

25. *Id.*

26. Rachel Abrams, *Walmart, With Amazon in Its Cross Hairs, Posts E-Commerce Gains*, N.Y. TIMES (May 18, 2017), https://www.nytimes.com/2017/05/18/business/walmart-online-sales-jump-63-percent.html?mcubz=3.

27. *Id.*

28. *See* Semuels, *supra* note 4.

29. U.S. DEP'T OF COMMERCE, QUARTERLY SUMMARY OF STATE AND LOCAL GOVERNMENT TAX REVENUE FOR 2017: Q1 2017), https://www.census.gov/content/dam/Census/library/publications/2017/econ/g17-qtax1.pdf [hereinafter TAX REVENUE SUMMARY 2017: Q1].

30. *Id.*

receipts make up 40.4% of state tax revenue,[31] and some local governments receive half of their budgets from sales taxes levied on top of the state rates.[32]

As a result, there is a positive correlation between taxable retail sales and state tax revenue: where taxable sales have begun to stagnate, so too have tax revenues. From 2013 to 2014, sales tax revenue rose 5.6%.[33] By contrast, sales tax revenue rose only 2% between the first quarters of 2016 and 2017.[34] The term "rose" may be misleading in this context. While the first quarter of 2017 still reported a growth, the *rate* of the growth was significantly lower than that of the 2013–2014 year, which is troubling when one considers that state spending is also increasing each year.[35]

To repurpose a popular analogy,[36] state budgets are leaky buckets from which an ever-increasing flow of water escapes in the form of public expenditures. The leak is immaterial as long as the output is as great or greater than the input. But where, as here, a source of income is petering out while expenditures continue to grow, it poses a significant problem for state economies. If trends continue as is, sales tax growth will continue to decrease while government expenditures continue to increase. Prospectively, this threatens the tax-dependent economies of states and local governments, particularly those who derive so much of their revenue from retail sales tax.[37] When the amount of water entering a leaky bucket fails to match or exceed the amount leaving it, the bucket will eventually run dry.

To limit their dependency on a declining revenue source and keep up with growing expenditures, states have begun to look to other markets to supplement their income. E-commerce is a rapidly expanding arena in retail that would help bolster sales tax revenue, thus restoring a more comfortable balance between output and input in state economies. If state governments

31. *Id.*

32. Semuels, *supra* note 4.

33. U.S. DEP'T OF COMMERCE, QUARTERLY SUMMARY OF STATE AND LOCAL GOVERNMENT TAX REVENUE FOR 2014: Q1 (2014), https://www.census.gov/content/dam/Census/library/publications/2014/econ/g14-qtax1.pdf.

34. TAX REVENUE SUMMARY 2017: Q1, *supra* note 29.

35. "Direct state and local spending on general government increased from approximately $1.1 billion in 1977 (in inflation-adjusted 2015 dollars) to $2.8 billion in 2015—a 170 percent increase over 38 years." *State and Local Expenditures*, THE URBAN INST., http://www.urban.org/policy-centers/cross-center-initiatives/state-local-finance-initiative/projects/state-and-local-backgrounders/state-and-local-expenditures (last visited Aug. 25, 2017).

36. The leaky bucket analogy derives from Arthur Okun's theory on public economics and the redistribution of wealth. *See* Bill Conerly, *Economic Impacts of Inequality*, FORBES (Aug. 18, 2014), https://www.forbes.com/sites/billconerly/2014/08/18/economic-impacts-of-inequality/#1a01e4f2530c.

37. Consider again those Southern states and local governments who derive as much as half of their income from sales and use taxes. *See* TAX REVENUE SUMMARY 2017: Q1, *supra* note 29; Semuels, *supra* note 4.

can develop a way to effectively access that revenue source—as some of the forward-thinking companies described above have done, to their notable benefit—then they may secure a flourishing resource that will help sustain their economies in the fast-approaching future.

## II. INTERNET RETAIL JURISPRUDENCE AND THE PHYSICAL PRESENCE REQUIREMENT

Having established that states would likely benefit from imposing sales and use taxes on internet retail, two inquiries naturally arise. First, do states have the authority to impose such a tax? And second, if they do have the authority, how should states go about incorporating an e-commerce sales and use tax into their state taxation schemes? These questions form the basis of discussion for Parts II through V.

With regard to the first question—whether or not states have the authority to systemically tax e-commerce—the short answer was, until recently, a qualified "no." No, because there have historically been significant obstacles to imposing sales and use tax on large portions of e-commerce revenue. Qualified, because as in many other areas of the law, the answer here is vastly more complex than a simple "yes" or "no."

As a preliminary matter, it is important to note that not all forms of e-commerce are created equally, at least, not for purposes of sales and use taxation. The term "e-commerce" casts a very broad net. It has been defined as "[t]he practice of buying and selling goods and services through online consumer services and of conducting other business activities using an electronic device and the Internet."[38] This definition includes both (1) internet retailers that are located within the territorial boundaries of the state, be it through their headquarters, storefronts, distribution centers, etc.; and (2) internet retailers located out-of-state, with no physical presence within the territorial bounds of the state. The second category may be interchangeably referred to as "remote retailers" or "out-of-state sellers."[39]

In the past, these two categories of e-commerce have not always received the same treatment for tax purposes.[40] Taxes imposed on out-of-state sellers who nonetheless maintained a physical location within the taxing

38. *E-commerce*, BLACK'S LAW DICTIONARY (10th ed. 2014).

39. "Out-of-state seller[s]" refers to those retailers whose place of incorporation or principal place of business is not the state imposing the tax. *See* Quill Corp. v. Heitkamp *ex rel.* North Dakota, 504 U.S. 298, 302 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018) (using the term to refer to a business incorporated in Delaware with offices in Illinois, California, and Georgia, that was operating in North Dakota); Nat'l Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753, 753-54 (1967) (referring to a business incorporated in Delaware with its principal place of business in North Kansas, doing business in Illinois).

40. *See Bellas Hess*, 386 U.S. 753.

state have been upheld,[41] while taxes imposed on out-of-state sellers with no physical locations in the taxing state have been invalidated.[42] These disparities may seem arbitrary at first glance, but in reality, they reflect the changing approaches to taxing out-of-state retailers.

Judicial approaches to taxing out-of-state retailers revolve primarily around two constitutional limits on a state's power to tax: the Due Process Clause and the Commerce Clause.[43] Within the last fifty years, the interpretations and applications of these constitutional limitations have changed significantly with regard to taxation by implementing different presence requirements for out-of-state retailers in the taxing states. This, in turn, has placed and removed obstacles for states hoping to impose taxes on e-commerce retailers, including those with and without physical presences in the taxing state.

To understand how these obstacles have arisen and changed over the course of the last half-century, case law in the area is highly instructive. In particular, three cases out of the United States Supreme Court highlight the changing treatment of out-of-state retail sales tax. The first, *National Bellas Hess, Inc. v. Department of Revenue of State of Illinois* ("*Bellas Hess"*), established a bright-line rule for analyzing state taxes under the constitutional requirement of Due Process.[44] The second, *Quill Corp. v. Heitkamp ex rel. North Dakota* ("*Quill"*), replaced the *Bellas Hess* rule for Due Process analyses and, in the same decision, preserved it for analyses under the Commerce Clause.[45] Finally, the third case, *Direct Marketing Ass'n v. Brohl* ("*Direct Marketing*"), signaled the Court's changing attitude toward the physical presence requirement and paved the way for the latest shift in e-commerce taxation jurisprudence.[46]

## A. Due Process and the *Bellas Hess* Bright-Line

In 1967, the mail order company National Bellas Hess ("National") appeared before the U.S. Supreme Court in an action to recover assessed use taxes.[47] These taxes were paid to the Department of Revenue of the State of Illinois, the defendant in the case, in accordance with section 439.3 of the

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41. *Id.* at 757 (noting that a state's taxing power has been upheld where a mail order seller maintained local retail stores).

42. *Id.* at 758 ("But the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail.").

43. *Quill*, 504 U.S. at 305.

44. *See Bellas Hess*, 386 U.S. at 753.

45. *See Quill*, 504 U.S. at 298.

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

47. *Bellas Hess*, 386 U.S. at 753-54.

Illinois Use Tax Act of 1965.[48] The act provided, in relevant part, that any retailer "[e]ngaging in soliciting orders within [Illinois] from users by means of catalogues or other advertising" could be classified as retailers doing business in the state.[49] As one such retailer, National was required to collect use taxes on any sales it made to customers within the State of Illinois.[50] The Illinois Supreme Court noted the following in its opinion:

> (National) does not maintain in Illinois any office, distribution house, sales house, warehouse or any other place of business; it does not have in Illinois any agent, salesman, canvasser, solicitor or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise it sells; it does not own any tangible property, real or personal, in Illinois; it has no telephone listing in Illinois and it has not advertised its merchandise for sale in newspapers, on billboards, or by radio or television in Illinois.[51]

The U.S. Supreme Court adopted this factual finding.[52]

National filed suit, arguing that Illinois's tax code violated the Due Process Clause of the Fourteenth Amendment and unconstitutionally burdened interstate commerce.[53] The Court in *Bellas Hess* agreed.[54] In its decision, the Court recognized that the Due Process Clause permits states to levy taxes on out-of-state businesses only when the state "has given [something] for which it can ask return."[55] This can be measured in terms of opportunities, benefits, or protection that the state has afforded the business.[56] The *Bellas Hess* Court therefore required "'some definite link, some minimum connection'" between the state and the retailer it sought to tax.[57]

With respect to out-of-state sellers, the Court was willing to grant the existence of minimum contacts where the retailer "maintained local retail stores" or had agents operating locally in the state.[58] However, where a seller's "only connection with customers in the State [was] by common

48. *Id.* at 754.
49. *Id.* at 755.
50. *Id.*
51. *Id.* at 754.
52. *Id.*
53. *Id.* at 756.
54. *Id.* at 760.
55. *Id.* at 765 (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)).
56. *J.C. Penney*, 311 U.S. at 444.
57. *Bellas Hess*, 386 U.S. at 756 (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954)).
58. *Id.* at 757.

carrier or the United States mail," the Court found that imposing taxes violated Due Process.[59] Such sellers did not receive sufficient benefits from the state for the state to exact taxes.[60] In making this distinction, the Court in *Bellas Hess* essentially created a bright-line rule for taxation and Due Process: retailers must have some form of physical presence in a state—i.e., a storefront, local sales force, or office—in order to be subject to the state's use tax laws.[61] Under the *Bellas Hess* holding, states imposing taxes on retailers without a physical presence would have "no legitimate claim to impose 'a fair share of the cost of the local government'" and would unjustifiably impose significant burdens on out-of-state retailers.[62] In this way, according to the Court, legislation like the Illinois Use Tax Act would undermine the very purpose of the Commerce Clause, which is to protect the national economy from such unjustifiable burdens.[63]

While e-commerce was almost certainly not contemplated in the 1967 *Bellas Hess* decision, some of the principles set forth by the Court are still applicable. Chiefly, although physical presence is no longer a bright-line *requirement* for taxing out-of-state retailers, it will generally be sufficient to establish a taxable nexus with the state.[64] Relating this premise back to the earlier discussion of the categories of e-commerce, internet retailers that *do* have a physical presence within the taxing state will likely be subject to the sales and use tax schemes of that state. The more difficult inquiry, and the one more germane to the goals of this discussion, is whether retailers that *do not* have a physical presence within the taxing state—remote internet retailers—may be required to collect sales and use tax. For this inquiry, it is instructive to look to subsequent changes in the law, beginning with the rule set forth in *Quill*.

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59. *Id.* at 758.

60. *Id.*

61. This bright-line rule was later expressly expanded to include sales tax, in addition to the original use tax. Quill Corp. v. Heitkamp ex rel. North Dakota, 504 U.S. 298, 315 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018) ("Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office.").

62. *Bellas Hess*, 386 U.S. at 760. If other states imposed upon out-of-state retailers their own varied tax rates, allowable exemptions, and record-keeping requirements, it would "entangle [retailers'] interstate business in a virtual welter of complicated obligations to local jurisdictions[.]" *Id.* at 759–60.

63. *Id.* at 760.

64. As will be discussed in the next subsection, the modern inquiry for Due Process is "whether a defendant's contacts with the forum made it reasonable, in the context of our federal system of Government, to require it to defend the suit in that State." *Quill*, 504 U.S. at 307. Purposeful availment via physical presence in the state likely satisfies this requirement.

### B. *Quill* and the Commerce Clause

Approximately twenty-five years after its decision in *Bellas Hess*, the U.S. Supreme Court was again called upon to address the issue of imposing sales and use taxes on remote retailers.[65] The Supreme Court ruled on *Quill* in 1992, which provided, until recently, the controlling jurisprudence on e-commerce taxation.[66]

The case began when the State of North Dakota filed an action seeking declaratory judgment against Quill Corporation ("Quill Corp.") that would require Quill Corp. to collect and pay a use tax on goods purchased for use within the state.[67] Quill Corp. was a mail-order office supply company with no offices, warehouses, employees, or significant personal property in North Dakota.[68] All sales to North Dakota customers, which amounted to approximately $1 million annually, were fulfilled via mail or common carrier.[69]

Similarly to Illinois in *Bellas Hess*, North Dakota's use tax statute required every "retailer maintaining a place of business" in the state to collect a use tax.[70] Included in this classification was "every person who engages in regular or systematic solicitation of a consumer market in th[e] state."[71] Therefore, North Dakota claimed that Quill Corp. should have been required to collect and pay a use tax on any items sold for use in the state, irrespective of its lack of physical presence in North Dakota.[72]

In addressing the claim, the Court considered whether the tax conformed with requirements under both the Due Process Clause and the Commerce Clause.[73] If the Court had chosen to apply the bright-line physical presence requirement laid out in *Bellas Hess*, the tax almost certainly would have failed Due Process muster. However, as the Court noted, its Due Process jurisprudence had "evolved substantially in the [twenty-five] years since *Bellas Hess*," largely precipitated by changes in personal jurisdiction jurisprudence.[74] Historically, courts relied on physical presence within a

65. *Id*. at 298.
66. *Id.*
67. *Id.* at 302.
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.* at 302–03.
72. *Id.* at 301.
73. *Id.* at 305.
74. *Id.* at 307. The interrelatedness of these two concepts—personal jurisdiction and taxation power—derives from their shared origin. Both arise from the Due Process requirement of the Federal Constitution's Fourteenth Amendment, which limits a state's power to affect the rights and obligations of persons not within that state's sovereign authority. Pennoyer v. Neff, 95 U.S. 714, 733 (1878). Both require "minimum contacts" to be established

state's territorial jurisdiction to satisfy Due Process.[75] As forms of notice—that is, service of summons—began to change, the Supreme Court shifted the cornerstone of Due Process from the rigid physical presence requirement to something less mechanical.[76]

In *International Shoe Co. v. Washington,* the Court articulated the test for Due Process as it pertained to *in personam* jurisdiction: whether maintaining a state's jurisdiction would offend "traditional notions of fair play and substantial justice."[77] This standard extended to corporations as well as individuals,[78] and in 1977, the standard was further extended by *Shaffer v. Heitner,* to cover "all assertions of state-court jurisdiction[.]"[79] Under the interpretation set out in *International Shoe* and extended by *Shaffer*, the Due Process Clause was satisfied when a corporation had "such contacts . . . with the state of the forum as to make it reasonable."[80] Under this test, even if a corporation had no physical presence in the taxing state, it could be subject to a state's jurisdiction if it had "purposefully avail[ed] itself of the benefits of an economic market in the forum State."[81] Stated another way, the Supreme Court has consistently rejected the notion that a lack of physical contact in a state can defeat personal jurisdiction there.[82]

This test reflected the Supreme Court's interpretation of "minimum contacts" at the time of *Quill*.[83] Accordingly, rather than relying on *Bellas Hess's* outmoded physical presence requirement, the Court in *Quill* looked to the Due Process test prescribed in *International Shoe.*[84] Under this test, the Court found that the Due Process Clause did not bar enforcement of North Dakota's use tax statute because Quill Corp. had purposefully directed

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between the state and the party sought to be brought within the state's authority, be that authority commercial or judicial. *See also*, *Quill*, 504 U.S. at 298 (requiring "minimum contacts" for imposing sales and use taxes); Int'l Shoe Co. v. Wash. Office of Unemployment Comp. & Placement, 326 U.S. 310, 316 (1945) (requiring "minimum contacts" for the maintenance of a suit by a state court). Accordingly, as the Court's interpretation of "minimum contacts" changes with personal jurisdiction case law, so too does it change with respect to tax law.

75. *Int'l Shoe*, 326 U.S. at 316 (citing *Pennoyer*, 95 U.S. at 733).

76. *Id.*

77. *Id.*

78. *Id.* at 316–17.

79. Shaffer v. Heitner, 433 U.S. 186, 212 (1977).

80. *Int'l Shoe*, 326 U.S. at 317.

81. Quill Corp. v. Heitkamp *ex rel.* North Dakota, 504 U.S. 298, 307 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

82. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985).

83. Although *Bellas Hess* was decided in 1967, a full twenty-two years after *International Shoe*, the Court's subsequent applications of the *International Shoe* standard placed it closer in time to the *Quill* decision of 1992. *See Quill*, 504 U.S. at 307 (referencing *Shaffer* and *Burger King*).

84. *Id.* at 308.

business activities at North Dakota residents with sufficient magnitude, such that imposing the tax would not offend "traditional notions of fair play and substantial justice."[85] This marked a significant shift from the mechanical physical presence test of *Bellas Hess*. Under the new rule, it was possible for a company like Quill Corp., whose only contacts with a state were through mail and common carrier, to be subject to that state's use tax laws—at least as far as Due Process restrictions were concerned. Applying that same principle to remote internet retailers, a state could theoretically impose sales and use tax on sales made within the state without violating the Due Process Clause.[86]

If the analysis had ended there, states would have at least had a chance of enforcing sales and use taxes against individual retailers, assuming they could prove minimum contacts. However, the constitutionality analysis for properly imposing a tax is two-fold. And, as the Court in *Quill* pointed out, "while a state may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause."[87] It is the latter wherein lay a persisting obstacle to taxing remote internet retailers: the Commerce Clause and its penumbra, the Dormant Commerce Clause.

By its express language, the Commerce Clause of the United States Constitution provides Congress the power "to regulate commerce with foreign nations, and among the several states[.]"[88] However, the Commerce Clause has been read by the Supreme Court to include a sort of "negative" or "dormant" aspect in addition to its affirmative grant of power to Congress.[89] The Dormant Commerce Clause acts through the courts even "in the absence of any action by Congress," with the purpose of preventing economic isolationism.[90] In other words, the courts use the Dormant Commerce Clause to strike down state laws that unduly burden the flow of commerce across state borders, including by taxing interstate commerce.[91]

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85. *Id.*

86. This assumes, for argument's sake, that the magnitude of the retailer's contacts with the state would be sufficient. The Court in *Quill* does not discuss at any length how to determine magnitude of contacts, but given that Quill Corp. sold approximately $1 million in North Dakota, it is likely fair to say that sales over $1 million in the taxing state would be sufficient to satisfy Due Process requirements.

87. *Id.* at 305.

88. U.S. CONST. art. I, § 8, cl. 3.

89. *E.g.*, W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 192 (1994) (recognizing a "negative" aspect of the Commerce Clause that prohibits economic protectionism and undue burdens on interstate commerce).

90. *Quill*, 504 U.S. at 309.

91. *See, e.g.*, *id.* at 309–10.

It is within this authority that the *Quill* Court undertook its Commerce Clause analysis of the North Dakota tax.[92] To be sustained against a Dormant Commerce Clause challenge, a tax must (1) be applied to an activity with a substantial nexus with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the state.[93] Both *Bellas Hess* and *Quill* draw specific attention to the first requirement, the "substantial nexus" requirement.[94] The question then becomes whether contact solely through mail or common carrier, as is the case with remote retailers, is sufficient to establish a substantial nexus with the taxing state. North Dakota argued that it must be sufficient if that same conduct was sufficient to satisfy the Due Process Clause.[95]

The Supreme Court disagreed.[96] In defense of this position, it explained the fundamental differences between the Due Process Clause and the Commerce Clause: the former is intended to ensure fairness, while the latter is designed to protect the structure of the nation's economy.[97] Included among these structural concerns is that of interstate commerce,[98] which *Bellas Hess* found to be unduly burdened by the taxation of remote retailers.[99] The Court in *Quill* seemed to agree with that assessment, finding that "the bright-line rule of *Bellas Hess* furthers the ends of the Dormant Commerce Clause" by ensuring retailers receive some benefit from the states before being subjected to taxes by those states.[100] Accordingly, the Court preserved the physical presence requirement of *Bellas Hess* for purposes of the Commerce Clause—but not for the Due Process Clause—and ultimately determined that North Dakota could not require Quill Corp. to collect use taxes for sales in the state.[101]

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92. *Id.* at 311.

93. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

94. *Quill*, 504 U.S. at 311.

95. "The State contends that the nexus requirements imposed by the Due Process and Commerce Clauses are equivalent and that if, as we concluded above, a mail-order house that lacks a physical presence in the taxing State nonetheless satisfies the due process 'minimum contacts' test, then that corporation also meets the Commerce Clause 'substantial nexus' test." *Id.* at 312.

96. *Id; see also* the discussion *supra* note 62 (relating to the unjustifiable burdens of allowing states to impose varied tax requirements on out-of-state sellers, which in turn receive little to no benefit from the states).

97. *Quill*, 504 U.S. at 312.

98. *Id.* ("Accordingly, we have ruled that [the Commerce Clause] prohibits discrimination against interstate commerce . . . and bars state regulations that unduly burden interstate commerce[.]") (citations omitted).

99. Nat'l Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753, 759–60 (1967).

100. *Quill*, 504 U.S. at 314–15.

101. *Id.* at 318–19.

This holding severely limited states' authority to tax certain types of e-commerce revenue. Under *Quill*, states were generally able to reach the sales of local internet retailers and even out-of-state retailers with a physical presence in the state.[102] However, *Quill* effectively blocked states from taxing an entire category of internet retailers—the remote retailers. The physical presence requirement barred the imposition of taxes on these retailers, irrespective of the amount of otherwise taxable sales done in the state. As a result, even though states could access *some* internet retailers for sales and use tax purposes, *Quill* remained a significant obstacle to states' ability to fully capitalize on the e-commerce marketplace. However, *Quill* was not without opposition, and Justice Kennedy's concurrence in the *Direct Marketing* decision in 2015, as well as Justice White's separate opinion in *Quill* itself, may well have laid the foundation for *Quill's* ultimate demise.

### C. Judicial Criticism of the *Quill* Decision

In 2015, Kennedy called upon the Court to strongly reconsider its holding in *Quill*—and to do it quickly.[103] "Given [the] changes in technology and consumer sophistication," he wrote in his concurring opinion to *Direct Marketing*, "it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*."[104] He cited a nearly $3 billion increase in e-commerce sales per year between the Court's decision in *Quill* and 2008, illustrating how "urgent" the cause for reconsideration has become.[105] *Quill*'s incompatibility with the changing times "inflict[s] extreme harm and unfairness on the [s]tates."[106] This call to action signaled an awareness in the Supreme Court that *Quill* no longer suited the nation's economy or, indeed,

102. Some states have also found that the physical presence requirement for substantial nexus may be satisfied "by others' in-state activities taken on behalf of an out-of-state retailer." This form of satisfaction has been referred to as "attributional nexus." Here, for example, an independent contractor—rather than an out-and-out employee—acting on a retailer's behalf could be sufficient to establish a nexus with the state seeking to impose sales and use tax on the retailer's sales in the state. Andrew J. Haile, *Affiliate Nexus in E-Commerce*, 33 CARDOZO L. REV. 1803, 1811–12 (2012).

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

104. *Id.*

105. Kennedy writes, "When the Court 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." *Id.* (citations omitted). Additionally, Kennedy points to "shortfall[s]" in state revenues, "unfairness to local retailers and their customers who do pay taxes at the register," and losses arising from an inability to tax sales from out-of-state vendors. *Id.* For example, "Colorado's losses in 2012 [were] estimated to be around $170 million." *Id.*

106. *Id.* at 1134.

even its jurisprudence.[107] It also showed a willingness—and, arguably, a demand—to change it.

Furthermore, Kennedy's call to reconsider was not the first decrial of the majority opinion in *Quill*. Three of the justices who concurred in the holding, including Kennedy, did so "based on *stare decisis* alone," creating a "tenuous" foundation upon which the ruling rests.[108] It is also worth noting that the *Quill* Court's partial upholding of *Bellas Hess* did not reflect the will of the entire Court of its time.[109] Through his partial dissent, White offered some constructive insight into why the Court's holding was perhaps in error, and why the Court might consider "giving *Bellas Hess* the complete burial it justly deserves" thereafter.[110]

As a starting point, White rejected the distinctions that the majority drew between the "substantial nexus" requirements under Due Process, which the majority described as a fairness inquiry, and those under the Commerce Clause, which the majority found to be largely structural.[111] Citing precedent, White asserted that the substantial nexus requirement was "grounded in the Due Process Clause, and not the Commerce Clause," and that there was no independent substantial nexus requirement under the Commerce Clause.[112] Consequently, in his view, there was no precedent nor justification for finding a nexus sufficient under one and insufficient under the other.[113]

Without recognizing an independent nexus requirement for the Commerce Clause, the holding in *Quill* would have likely been very different: the contacts would have either failed under both clauses or succeeded under both clauses. Given the Court's more flexible inquiry for Due Process considerations under *International Shoe*,[114] the argument could

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107. Kennedy notes that, "In *Quill*, the Court should have taken the opportunity to reevaluate *Bellas Hess* not only in light of *Complete Auto* but also in view of the dramatic technological and social changes that had taken place in our increasingly interconnected economy." *Id.* at 1134–35.

108. *Id.* at 1134. Kennedy calls *Quill* "[a] case questionable even when decided." *Id.* at 1135.

109. White wrote a partial dissent to the majority's opinion, while Justice Scalia (with Kennedy and Justice Thomas joining) set out to qualify their concurrence with upholding the Commerce Clause portion of the *Bellas Hess* decision. *See* Quill Corp. v. Heitkamp ex rel. North Dakota, 504 U.S. 298 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

110. *Id.* at 322 (White, J., concurring in the judgment in part, dissenting in part).

111. *Id.* at 325.

112. *Id.* at 327.

113. *Id.*

114. *See* Part II-b for a discussion on the adoption and application of the *International Shoe* standard.

be made that the Court would have done away with the physical presence requirement entirely.

However, even if this distinction remained good law, White posited that the physical presence requirement had still outlived its usefulness.[115] In his opinion, "physical presence frequently [had] very little to do with a transaction a State might seek to tax,"[116] and out-of-state sellers still benefited from the infrastructures of the states in which they did business.[117] He explained:

> Nevertheless, an out-of-state direct marketer derives numerous commercial benefits from the State in which it does business. These advantages include laws establishing sound local banking institutions to support credit transactions; courts to ensure collection of the purchase price from the seller's customers; means of waste disposal from garbage generated by mail-order solicitations; and creation and enforcement of consumer protection laws, which protect buyers and sellers alike, the former by ensuring that they will have a ready means of protecting against fraud, and the latter by creating a climate of consumer confidence that inures to the benefit of reputable dealers in mail-order transactions.[118]

In so recognizing, White established a cognizable argument *against* the physical presence requirement, even through the structural lens of the Commerce Clause. By accessing a state's financial institutions, its courts, and its public services—even without a physical presence in the taxing state—remote retailers would seem to obligate themselves to contribute their just share of the state tax burden. Otherwise, the *Quill* Court risked "perpetuating a rule that create[d] an interstate tax shelter for one form of business"[119]—in this case, internet retailers—without offering a comparable advantage for its competitors. Kennedy echoed this point in his *Direct Marketing* concurrence, discussing the "concomitant unfairness to local retailers and their customers" of, effectively, shielding remote retailers from sales tax obligations.[120]

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115. *Quill*, 504 U.S. at 327–28.
116. *Id.* at 328.
117. *Id.*
118. *Id.*
119. *Id.* at 329 (White, J., concurring in the judgment in part, dissenting in part).
120. Direct Mktg. Ass'n v. Brohl, 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring).

Additionally, while the physical presence requirement was heralded by the Court to establish clear-cut boundaries for states' tax authority,[121] as well as encourage "settled expectations" for businesses and investors,[122] subsequent caselaw showed that the physical presence requirement was perhaps not as clear-cut as the *Quill* majority suggested. White's dissent provided some guidance in that regard, as well.[123] While the bright-line test is more concrete than, say, a balancing inquiry, it still raised a vital question: what constitutes "physical presence"? As White pointed out, "[r]easonable minds surely can, and will, differ over what showing is required to make out a 'physical presence' adequate to justify imposing responsibilities for use tax collection."[124]

This proverbial gray area invited what might be construed as veiled judicial resistance by lower courts to the full sweep of *Quill*. For example, in *National Geographic Society v. California Board of Equalization* ("*National Geographic*"), the Court found that a company with two offices in the State still had a sufficient nexus with the State to be subject to use tax.[125] On its face, this holding seems unproblematic. However, when one considers that each office housed only one salesperson and one secretary,[126] and that both offices together made only $1 million annually in sales,[127] the case begins to raise concerns: namely, how much physical presence is required to justify imposing sales tax liability?

In *National Geographic*, the Court expressly rejected a "slightest presence" standard for satisfying physical presence.[128] However, that qualification in and of itself, as White pointed out in *Quill*, would seem to shift the test away from a true bright-line rule.[129] If too little physical presence will not satisfy the test, then where and how should that line be drawn? To determine physical presence, should courts look at the number of employees in the taxing state? The number of offices? The amount of property owned in the taxing state? With shoppers' favorite stores just "a click away—regardless of how close or far the nearest storefront[,]" Kennedy

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121. Thus, reducing litigation concerning those taxes. *Quill*, 504 U.S. at 315–16.

122. *Id.* at 316.

123. *See id.* at 330 (White, J., concurring in the judgment in part, dissenting in part).

124. *Id.* at 330–31.

125. *See* Nat'l Geographic Soc'y. v. Cal. Bd. of Equalization, 430 U.S. 551 (1977).

126. *Id.* at 554 n.2.

127. *Id.* at 556. Compare this to Quill Corp., which also made almost $1 million sales to about 3,000 customers in North Dakota and was the sixth largest vendor of office supplies in the state, but who under the *Quill* decision, was not liable for North Dakota sales tax. *Quill*, 504 U.S. at 302.

128. *Nat'l Geographic*, 430 U.S. at 556.

129. *Quill*, 504 U.S. at 330 ("In my view, the question of Quill's actual physical presence is sufficiently close to cast doubt on the majority's confidence that it is propounding a truly 'bright-line' rule.").

questioned whether physical presence was even an appropriate metric at all.[130]

Ultimately, between the lingering uncertainty of the metes and bounds of physical presence, the purported unfairness of its protection to remote retailers, and the need to respond to the ever-changing reality of e-commerce, it was perhaps only a matter of time before the Court reconsidered the place of physical presence in e-commerce taxation.[131]

## III. THE *WAYFAIR* DECISION

Nearly twenty-five years after its decision in *Quill*, the Supreme Court was presented with the opportunity to revisit its position on the physical presence requirement for internet retail taxation. That opportunity came when South Dakota enacted Senate Bill 106 ("S. 106") in 2016.[132] S. 106 was enacted "to provide for the collection of sales taxes from certain remote sellers, to establish certain Legislative findings, and to declare an emergency."[133] In effect, S. 106 "requires out-of-state sellers to collect and remit sales tax 'as if the seller had a physical presence in the state.'"[134] South Dakota limited the reach of S. 106, however, by (1) restricting its application to remote retailers that, "on an annual basis, deliver more than $100,000 of goods or services into the State or engage in 200 or more separate transactions for the delivery of goods or services into the State"; (2) foreclosing any retroactive application of the Act's sales tax collection and remission requirements; and (3) staying the Act's effective date until the constitutionality of the law could be established.[135]

To satisfy the third limitation and to conform to provisions of S. 106 requiring "expeditious judicial review," South Dakota filed a declaratory judgment action in state court against a number of merchants making sales in South Dakota, including Wayfair, Inc., which each had no employees or real estate in the state and collected no South Dakota sales tax on its transactions.[136] The action sought "a declaration that the requirements of the Act [were] valid and applicable to respondents and an injunction requiring

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

131. *See id.* ("The legal system should find an appropriate case for this Court to reexamine *Quill* and *Bellas Hess*.").

132. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018) ("In 2016, South Dakota confronted the serious inequity *Quill* imposes by enacting . . . S. 106, 2016 Legis. Assemb., 91st Sess. (S.D. 2016)[.]").

133. *Id.* at 2088.

134. *Id.* at 2089.

135. *Id.*

136. *Id.*

respondents to register for licenses to collect and remit sales tax," despite the *Bellas Hess* and *Quill* precedent clearly requiring physical presence for the imposition of sales tax requirements.[137]

Indeed, South Dakota plainly recognized the conflicting precedent. In response to the merchants' motion for summary judgment at the trial court level, South Dakota "conceded that [S. 106 could not] survive under *Bellas Hess* and *Quill*"; however, it asked the judiciary to reconsider those decisions "in light of current economic realities."[138] The trial court granted the merchants' motion for summary judgment, and the South Dakota Supreme Court affirmed based upon existing U.S. Supreme Court precedent.[139] In January 2018, the Supreme Court granted certiorari to consider, once again, whether physical presence should remain the standard for e-commerce and remote retail taxation.[140]

### A. The *Wayfair* Decision

Arguments for *South Dakota v. Wayfair, Inc.* ("*Wayfair*") were heard in April 2018, and on June 21, 2018, the *Wayfair* Court issued the opinion that would be the death knell for the physical presence requirement in e-commerce taxation.[141] A closely-divided Supreme Court elected to uphold the South Dakota tax scheme, and in doing so, overruled the *Quill* decision and the common law it had created.[142] It did so on the belief that "*Quill* was flawed on its own terms."[143] Specifically, the Court highlighted three weaknesses of *Quill* that, in its view, established the need to change directions: (1) *Quill*'s flawed interpretation of the nexus requirement; (2) the generation, rather than resolution, of "market distortions" by the physical presence requirement; and (3) the "arbitrary, formalistic distinction[s]" imposed by *Quill*, which "modern Commerce Clause precedents

137. *Id.*

138. *Id.*

139. In its opinion, the South Dakota Supreme Court stated, "However persuasive the State's arguments on the merits of revisiting the issue, *Quill* has not been overruled. *Quill* remains the controlling precedent on the issue of Commerce Clause limitations on interstate collection of sales and use taxes" and elected to "leave to that Court 'the prerogative of overruling its own decisions.'" State v. Wayfair Inc., 901 N.W.2d 754, 761 (S.D. 2017), *cert. granted* South Dakota v. Wayfair, Inc., 138 S. Ct. 735 (2018), *and vacated and remanded* South Dakota v. Wayfair, 138 S. Ct. 2080 (2018).

140. *Wayfair*, 138 S. Ct. 735.

141. *Wayfair*, 138 S. Ct. 2080.

142. The decision was 5–4, with Kennedy delivering the opinion of the Court, in which Justices Thomas, Ginsburg, Alito, and Gorsuch joined; Justices Thomas and Gorsuch filing concurring opinions; and Chief Justice Roberts filing a dissenting opinion, in which Justices Breyer, Sotomayor, and Kagan joined. *Id.* at 2087.

143. *Id.* at 2092.

disavow."[144] As discussed in greater detail below, many of these criticisms track with previous concerns raised about the *Quill* decision.

First, the Court stated that physical presence is not necessary to create a substantial nexus with a state for purposes of imposing a sales tax.[145] As discussed above, the Supreme Court has consistently taken the position that "a business need not have a physical presence in a State to satisfy the demands of due process."[146] In that regard, the *Quill* Court was in harmony with its successors in *Wayfair*; it held that, for purposes of Due Process, physical presence was unnecessary.[147] Where the *Quill* Court erred, according to *Wayfair*, was in applying a different rule to substantial nexus determinations under the Commerce Clause.[148] Rather, neither Due Process *nor* the Commerce Clause requires physical contact with the taxing state; instead, "[t]here just must be 'a substantial nexus with the taxing State.'"[149] Further, the *Wayfair* Court stated that the sale of goods or services into a taxing state "has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State."[150] Accordingly, because S. 106 applies only to sales of "tangible personal property, products transferred electronically, or services for delivery into South Dakota[,]"[151] and further, only to retailers that do either $100,000 worth in sales or 200 separate transactions into the state, the *Wayfair* Court found that there was a substantial nexus, regardless of the merchants' lack of physical presence in South Dakota.[152]

Second, the Court raised concerns about market interference created by the physical presence requirement of *Quill*.[153] By prohibiting states from taxing remote retailers, *Quill* effectively established a sort of judicially-created tax shelter for those retailers, while shifting the tax burden to local retailers and their customers.[154] Remote retailers had a competitive advantage because they could avoid the "regulatory burdens of tax

144. *Id.* at 2085.

145. *Id.* at 2093.

146. *Id.* (citing Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476 (1985)).

147. Quill Corp. v. Heitkamp *ex rel.* North Dakota, 504 U.S. 298, 308 (1992), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

148. *Wayfair*, 138 S. Ct. at 2093 ("When considering whether a State may levy a tax, Due Process and Commerce Clause standards may not be identical or coterminous, but there are significant parallels. The reasons given in *Quill* for rejecting the physical presence rule for due process purposes apply as well to the question whether physical presence is a requisite for an out-of-state seller's liability to remit sales taxes.").

149. *Id.*

150. *Id.* at 2092.

151. *Id.*

152. *Id.* at 2099.

153. *Id.* at 2092.

154. *Id.* at 2094.

collection" and offer lower prices to consumers than their local counterparts could, solely because they had no real estate or employees in the taxing state.[155] This criticism echoes Kennedy's *Direct Marketing* concurrence, where he also expressed concerns about the "unfairness" of excusing remote retailers from paying their "fair share" of state taxes.[156] Furthermore, *Quill* actually incentivized retailers to avoid establishing physical contacts with a state, thus discouraging the creation of "storefronts, distribution points, and employment centers that otherwise would be efficient or desirable."[157] In short, the *Wayfair* Court found that it is "not the purpose of the [C]ommerce [C]lause to relieve those engaged in interstate commerce from their just share of state tax burden," nor is it the purpose of the Commerce Clause to empower the judiciary to distort the marketplace.[158] According to the Court,

> The Commerce Clause must not prefer interstate commerce only to the point where a merchant physically crosses state borders. Rejecting the physical presence rule is necessary to ensure that artificial competitive advantages are not created by this Court's precedents. This Court should not prevent States from collecting lawful taxes through a physical presence rule that can be satisfied only if there is an employee or a building in the State.[159]

Consequently, in order to abolish any artificial competitive advantages created by the Court through its precedent, the Court rejected the physical presence requirement and allowed an economic nexus to satisfy the Commerce Clause.[160]

Third, echoing the criticism of White in his partial dissent of *Quill*, the *Wayfair* Court decried the physical presence requirement as an "anachronistic"[161] distinction that "simply makes no sense."[162] The Court

155. *Id.* The Court also discusses the economic realities supporting the taxation of remote retailers, including estimates that *Bellas Hess* and *Quill* cause states to lose between $8 and $33 billion every year and low consumer compliance rates with use tax collection. *Id.* at 2088.

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

157. *Wayfair*, 138 S. Ct. at 2094.

158. *Id.*

159. *Id.*

160. *Id.* at 2094.

161. Recall in his partial dissent, White called the physical presence requirement an "anachronistic notion" and discussed the illogic of retaining such a requirement for the taxation of remote retailers. Quill Corp. v. Heitkamp *ex rel.* North Dakota, 504 U.S. 298, 328 (2018) (White, J., concurring in the judgment in part, dissenting in part), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

162. *Wayfair*, 138 S. Ct. at 2094–95.

used the illustration of two online furniture retailers, one with a warehouse in the South Dakota, and one with a warehouse just outside South Dakota and a virtual showroom available to consumers to view the selection.[163] In this thought experiment, which is a reality for online retailers like Wayfair, Inc.,[164] the first retailer would be subject to South Dakota's sales tax requirements, even for those sales that had nothing to do with the warehouse, while the second retailer could not be subjected to the state's sales tax requirements, even if it made the same or greater quantity of sales to South Dakota consumers.[165] It is, as the Court pointed out, difficult to understand why one may be burdened with collecting and remitting sales tax, while the other may not, on an "arbitrary" ground such as physical presence.[166]

For that reason, and for those discussed before it, the *Wayfair* Court overruled *Quill* and finally put to rest the physical presence requirement in its entirety.[167] Without physical presence, the analysis now aligns with the *Complete Auto Transit, Inc. v. Brady* test, which is simply "whether the tax applies to an activity with a substantial nexus with the taxing State."[168] The Court applied this new standard to South Dakota's S. 106, which allows the state to impose its sales tax on remote retailers that exceed the *de minimis* threshold of $100,000 or 200 transactions of goods and services delivered into the state, and ultimately held that the legislation passed constitutional muster.[169] The Court reasoned that retailers that exceed the *de minimis* threshold of business into South Dakota and maintain an "extensive" virtual presence in the state have "availed [themselves] of the substantial privilege of carrying on business in South Dakota."[170] Thus, the substantial nexus requirement is satisfied. This holding marks a new age in remote retail tax liability, the effects of which are numerous, varied, and discussed in greater detail below.

163. *Id.* at 2094.

164. For example, in 2016, Wayfair, Inc. launched an augmented reality mobile application that would allow shoppers to "explore, rearrange, and discover furniture and décor from Wayfair's catalog" against the backdrop of their own outdoor space. *Wayfair Launches Virtual Reality App to Customize Outdoor Spaces with Furnishings and Décor*, WAYFAIR.COM (Aug. 23, 2016), https://investor.wayfair.com/investor-relations/press-releases/press-releases-details/2016/Wayfair-Launches-Virtual-Reality-App-to-Customize-Outdoor-Spaces-with-Furnishings-and-Dcor/default.aspx.

165. *Wayfair*, 138 S. Ct. at 2094.

166. *Id.* 2096.

167. *Id.* at 2099.

168. *Id.*

169. *Id.*

170. *Id.*

### B. Effects and Implications of the *Wayfair* Decision

As a starting point, the most obvious effect of the *Wayfair* decision is that physical presence is no longer a necessary element of substantial nexus for taxing remote retailers.[171] That is not to say physical presence is no longer considered as part of the substantial nexus analysis; however, it is now possible to have the latter without the former.[172] From this primary effect, however, flow numerous secondary ramifications that will further shape the future of e-commerce taxation—some for better, and some, perhaps, for worse.

Under the *Wayfair* rule, states may now impose taxes on the sales of certain retailers with no physical presence within the state.[173] This opens the field for states to collect what the Government Accountability Office ("GAO") estimates to be billions of dollars annually in previously untapped revenues.[174] In turn, this bolsters states' sales tax bases, which for some states comprise a majority of their general funds.[175] And, at least at first glance, it also levels the proverbial playing field between local retailers and remote retailers with respect to sales tax collection.[176]

However, as the dissent in *Wayfair* indicates, the reality may be more complicated than a simple balancing of the scale, and the purported benefits of removing the physical presence requirement may also come with notable costs.[177] *Bellas Hess*, which first established the physical presence requirement and its protection of remote retailers from state sales tax liability, was decided in 1967.[178] Accordingly, retailers operated under some configuration of the physical presence requirement for over fifty years before the *Wayfair* case was decided. Under that rule, e-commerce grew into a thriving, prosperous market,[179] and the alteration of that rule should not be

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171. *Id.* at 2097.

172. *Id.* at 2093 ("Although physical presence 'frequently will enhance' a business' connection with a State, '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.'").

173. This is not a blanket rule, as discussed later in the section, but the removal of the physical presence requirement certainly gives states greater access to a broader range of retailers than they preciously had. *See id.*

174. *Id.* at 2088, 2103 (majority opinion and Roberts, C. J., dissenting, respectively) (citing U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-18-114, REPORT TO CONGRESSIONAL REQUESTERS: SALES TAXES, STATES COULD GAIN REVENUE FROM EXPANDED AUTHORITY, BUT BUSINESSES ARE LIKELY TO EXPERIENCE COMPLIANCE COSTS 5 (2017)).

175. *Id.* at 2088 (majority opinion).

176. *Id.* at 2094.

177. *See id.* at 2101 (Roberts, C. J., dissenting).

178. Nat'l Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753 (1967).

179. *See supra* Section I.

undertaken lightly.[180] A convincing argument could be made, after all, that it is not mere coincidence that e-commerce has prospered so greatly under the physical presence rule; rather, it could be said that the rule is a cause of, rather than a mere correlation to, the strength of the e-commerce market today.[181]

With such a critical market hinging on the Court's decision, one can understand the dissent's unease with a decision that leaves e-commerce tax liability on unsteady ground. Indeed, in the wake of *Wayfair*, remote retailers know that their lack of physical presence alone will not shield them from state sales tax liability. However, while the physical presence "bright-line" was by no means clear-cut,[182] it still offered more guidance than the substantial nexus analysis as it now stands. By answering the question before it—whether physical presence should be required to establish substantial nexus for purposes of imposing sales tax on remote retailers—the Court in *Wayfair* raised so many more. What, if not physical presence, are the metes and bounds of substantial nexus? May states set a lower threshold than $100,000 in sales or 200 separate transactions into the state and still satisfy the requirement? In fact, must states set a *de minimis* threshold in their sales tax legislation at all? Further, to take a broader view of the issue, is it even necessary that states base their sales tax schemes on the economic involvement of retailers with the state, or is there some other metric by which substantial nexus may be established?

Arguably, states looking to take a more well-settled path could simply copy South Dakota's approach with S. 106 and would thereby also survive constitutional challenge. However, even that route could not guaranty the validity of a state's tax scheme, given the other potentially invalidating Commerce Clause principles that the Court did not discuss or resolve.[183] Specifically, the Court identified the risk of discrimination against

180. In his dissent in *Wayfair*, Roberts avers that *Congress*, rather than the judiciary, should spearhead any changes to e-commerce taxation. *Wayfair*, 138 S. Ct. at 2101 (Roberts, C.J., dissenting) ("E-commerce has grown into a significant and vibrant part of our national economy against the backdrop of established rules, including the physical-presence rule. Any alteration to those rules with the potential to disrupt the development of such a critical segment of the economy should be undertaken by Congress. The Court should not act on this important question of current economic policy, solely to expiate a mistake it made over 50 years ago.").

181. *Id.* at 2104 ("An erroneous decision from this Court may well have been an unintended factor contributing to the growth of e-commerce.").

182. *See* Quill Corp. v. Heitkamp *ex rel.* North Dakota, 504 U.S. 298, 330–31 (White, J., concurring in the judgment in part, dissenting in part), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

183. *Wayfair*, 138 S. Ct. at 2099.

interstate commerce, the potential for retroactive application, and unduly burdensome tax requirements as areas for concern moving forward.[184]

As to the first, the risk of discrimination against interstate commerce, states must consider that South Dakota's economic approach to substantial nexus is inherently more suited to a state with a destination-based tax system.[185] In the destination-based system, taxes on goods that cross state lines are imposed at their ultimate destination—usually the purchaser, but not always, as is the case of import-for-export or sale-for-resale—because that is typically where the goods are consumed.[186] This is generally thought to promote neutrality between intrastate and interstate commerce because it treats "all goods consumed in the state in the same way, regardless of the location from which they were shipped."[187] Accordingly, for states such as South Dakota that use a destination-based tax system,[188] there is little cause for concern.

However, to understand why the economic nexus approach needs a destination-based system, it helps to consider an example of a state with a different system. In Tennessee, a taxable sale occurs upon "any transfer of title or possession, or both" for consideration.[189] This is fine when the title and possession are transferred simultaneously. On the other hand, imagine a scenario where an internet retailer *in* Tennessee makes a sale to a customer in a destination-tax state; imagine further that title transfers, as it often does, the moment the retailer places the good into transport with a common carrier. In this scenario, the retailer could theoretically be liable for Tennessee sales tax for the transfer of *title* and for the destination state's sales tax for the transfer of *possession*.

This risk of double-taxation obviously raises very serious Dormant Commerce Clause concerns, and under South Dakota's approach in *Wayfair*,

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184. These issues, the Court found, were not sufficient to "justify retaining [an] artificial, anachronistic rule" such as physical presence "that deprives States of vast revenues from major businesses." *Id.* at 2099–100.

185. Charles E. McClure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269, 318 (1997) ("Tax policy considerations suggest that sales taxes should be imposed on a destination basis—that tax should be collected by the jurisdiction where consumption occurs, not where production occurs.").

186. 2 JEROME HELLERSTEIN, WALTER HELLERSTEIN & JOHN A. SWAIN, STATE TAXATION ¶ 18.02[1] (3d ed. 2012).

187. *Id.*

188. South Dakota considers the location a sale occurs to be the location where the ultimate consumer receives the product. SOUTH DAKOTA DEP'T OF REVENUE, SALES AND USE TAX GUIDE 3 (2018).

189. TENN. CODE ANN. § 67-6-102(80)(A) (West 2018). Many other states share this definition of a taxable sale. However, differing interpretations of export and resale exemptions in those states keep the emphasis on the ultimate consumption of the good at its destination, HELLERSTEIN, *supra* note 186, at ¶18.02[2](a), which is less germane to this illustration.

both "taxable sales" could count toward a retailer's nexus with each state. Accordingly, even if a state such as Tennessee mirrored South Dakota's legislation, the nature of the rest of its tax structure could ultimately render its e-commerce taxation legislation invalid under the Commerce Clause.

Next, the Court recognized retroactivity as a potential area of complication.[190] In South Dakota's case, S. 106 expressly prohibits retroactive application of its sales tax obligations.[191] Accordingly, the issue of retroactivity was not before the *Wayfair* Court, and it was not definitively ruled upon.[192] This leaves something of an open door for states following South Dakota's lead; they may either create prospective legislation, as did South Dakota, or they may attempt to retroactively require remote retailers to collect and remit sales tax on items already sold. Such a retroactive application could constitute double tax burden, where states have imposed use taxes upon the consumer of the good before *Wayfair* and may later seek to impose sales tax liability on the retailer for the same transaction.[193] This could render invalid a state's e-commerce taxation legislation, even if the state followed South Dakota's rule and the *Wayfair* opinion in all other respects.[194]

Finally, there is the risk of unduly burdening interstate commerce with the imposition of sales tax on remote retailers.[195] The most notable burden, as it pertains to sales tax liabilities of remote retailers, is the administrative cost of compliance with differing tax schemes across multitudinous jurisdictions.[196] Specifically, as the *Quill* Court noted, "a state tax might unduly burden interstate commerce" by subjecting retailers to the various and often dissimilar tax-collection obligations in thousands of different taxing jurisdictions.[197] For example, the dissent in *Wayfair* discusses how "New Jersey knitters pay sales tax on yarn purchased for art projects, but not on yarn earmarked for sweaters," and "Texas taxes sales of plain deodorant at 6.25 percent but imposes no tax on deodorant with antiperspirant."[198]

To further compound this complication, there were an estimated 10,814 different tax jurisdictions across the United States in October 2017,

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190. *Wayfair*, 138 S. Ct. at 2099.

191. *Id.* at 2089; *see also* S.D. CODIFIED LAWS § 10-64-6 (2018) ("No obligation to remit the sales tax required by this chapter may be applied retroactively.").

192. *Wayfair*, 138 S. Ct. at 2099.

193. Brief of Amici Curiae Law Professors and Economists in Support of Petitioner at 7 n.5, South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018) (No. 17-494), 2018 WL 1203458.

194. *Id.*

195. *Wayfair*, 138 S. Ct. at 2098.

196. *Id.* at 2104 (Roberts, C.J., dissenting).

197. *Id.* at 2093 (majority opinion) (quoting Quill Corp. v. Heitkamp *ex rel.* North Dakota , 504 U.S. 298, 313 n.6 (1992)).

198. *Id.* at 2103-04 (Roberts, C.J., dissenting).

and as many as 1,594 taxing jurisdictions in a single state.[199] Remote retailers doing business in multiple states must contend not only with the different tax schemes of the different states, but also the different tax schemes across individual taxing jurisdictions *within* those states. In his dissent, Chief Justice Roberts voiced concerns that this burden will not only negatively impact interstate commerce, but will fall disproportionately on small businesses, particularly those "that do not have established legal teams, software systems, or outside counsel to assist with compliance related questions."[200] Additionally, software that might help businesses comply with such diverse tax requirements across numerous jurisdictions is "still in its infancy" and thus may not mitigate the immense burdens of regulatory compliance for remote retailers.[201]

The Court did not address these burdens in any great detail on account of South Dakota's membership in the Streamlined Sales and Use Tax Agreement ("SSUTA"), which "affords small merchants a reasonable degree of protection."[202] As the Court recognized, the more than twenty states that are party to the SSUTA present fewer compliance challenges to remote retailers.[203] The SSUTA requires a single, state-level tax administration, uniform definitions of products and services, simplified tax rate structures, and uniform destination-based sourcing for sales into a state from a remote retailer.[204] This minimizes compliance costs *within* a particular state, which reduces the burden on retailers doing business with that state.

However, as of the date of publication of this Article, only twenty-three states are fully parties to the SSUTA.[205] This means that the majority of states do not offer the same protection to remote retailers as does South Dakota, and the SSUTA does not act to alleviate compliance burdens for those states. Consequently, even if a state that is not party to the SSUTA

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199. April Loughead, *Growing Number of State Sales Tax Jurisdictions Makes South Dakota v. Wayfair That Much More Imperative*, TAX FOUND. (Apr. 17, 2018), https://taxfoundation.org/growing-number-state-sales-tax-jurisdictions-makes-south-dakota-v-wayfair-much-imperative/.

200. *Wayfair*, 138 S. Ct. at 2104 (Roberts, C.J., dissenting).

201. *Id.*

202. *See id*. at 2098–99 (majority opinion).

203. *Id.* at 2099–100.

204. *Id.*

205. The full member states are Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming. *See* Streamlined Sales Tax Governing Board, *State Info*, https://www.streamlinedsalestax.org/index.php?page=state-info (last visited Aug. 10, 2018). Tennessee is an "associate" member, which means it has substantially, but not entirely, complied with the SSUTA requirements. *Id.*

replicates South Dakota's e-commerce tax schemes, it may still run afoul of the Commerce Clause as unduly burdensome to interstate commerce.

Owing to that area of uncertainty, as well as the others discussed above, *Wayfair* cannot be said to be the ultimate solution to the e-commerce taxation conundrum. Perhaps, rather, it is only a single judicial step in what may be a multi-branch effort to both capitalize on the massive e-commerce revenue source and foster its continued growth in the years to come. As both the majority and the dissent in *Wayfair* point out, Congress may legislate to address the many problems still facing e-commerce taxation.[206] It may, in fact, be better suited to the task than the Court, given the capacity of Congress to "investigate and analyze facts beyond anything the Judiciary could match" and to "focus directly on current policy concerns rather than past legal mistakes."[207] However, until Congress takes the stage, if in fact it ever does, states must look to *Wayfair* to guide their sales and use tax schemes for remote retailers. Accordingly, the next section analyzes states' current approaches to taxing remote retailers through the lens of *Wayfair* to determine what works, what doesn't, and what remains to be seen.

## IV. STATE APPROACHES TO TAXING E-COMMERCE REVENUE

Even before *Quill* had taken its final bow on the remote retail taxation stage, many states took steps to prepare for—and even help bring about—its metaphorical curtain call. In an effort to capitalize on e-commerce revenue, many states have been requiring remote internet retailers to collect and remit sales and use tax "they feel e-retailers owe to [them]," irrespective of the *Quill* impediments.[208] States have employed a variety of methods to accomplish this aim, but three methods have emerged in recent years as the most prominent among the fifty states: economic nexus, affiliate (and click-through) nexus, and reporting requirements.[209] Each looks to a different

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206. *Wayfair*, 138 S. Ct. at 2098, 2101. However, Roberts has expressed concerns that the *Wayfair* decision may, in fact, impede Congress' attempts to regulate in this area. *Id.* at 2102–03 (Roberts, C.J., dissenting) ("Nothing in today's decision precludes Congress from continuing to seek a legislative solution. But by suddenly changing the ground rules, the Court may have waylaid Congress's consideration of the issue. Armed with today's decision, state officials can be expected to redirect their attention from working with Congress on a national solution, to securing new tax revenue from remote retailers.").

207. *Id.* at 2104.

208. Geoffrey E. Weyl, *Quibbling with Quill: Are States Powerless in Enforcing Sales and Use Tax-Related Obligations on Out-of-State Retailers?,* 117 PENN ST. L. REV. 253, 264 (2012) ("[D]ue to declining revenue during the current economic recession, many states have sought to enact legislation that forces e-retailers to collect sales taxes. The states argue that they are being unreasonably deprived of revenue they are entitled to receive.").

209. *Remote Seller Nexus Chart*, SALES TAX INST. (Oct. 5, 2018), http://www.salestaxinstitute.com/resources/remote-seller-nexus-chart.

retail component to establish the state's authority to tax a remote retailer, and each has its unique benefits and disadvantages with respect to e-commerce taxation, as well as unique implications under the new *Wayfair* precedent.

## A. Economic Nexus

In a survey of all fifty states, economic nexus emerged as the modern trend in taxing remote internet retailers even before *Wayfair* approved South Dakota's economic nexus-based tax scheme.[210] Rather than placing the emphasis on a retailer's physical presence within the state, the economic nexus approach looks to whether a taxable sale occurs within the state.[211] Stated another way, even if a retailer has no physical presence within the taxing state, if it makes taxable sales *into* the state, then that state may theoretically impose sales and use taxes on those sales. The approach is predicated on the idea that "[t]axable activity should imply nexus."[212] It also conforms with *International Shoe*'s Due Process Principles, which provide that if an out-of-state seller "purposefully avails itself of the benefits of an economic market in the forum State," Due Process is satisfied.[213] Now that *Wayfair* has effectively made Due Process and the Commerce Clause analyses coterminous, the Commerce Clause is, by extension, also satisfied by such availment. Essentially, by directing its economic activities into a state, a retailer makes reasonable the exercise of state authority.

There are limits to the application of the economic nexus approach, however. Conventional wisdom on economic nexus taxation is that it should only be applied to retailers who surpass a certain *de minimis* "threshold" of sales in the state to avoid overburdening small businesses and businesses doing only negligible business in the taxing state.[214] It also helps states avoid Due Process and Commerce Clause concerns by preventing them from taxing retailers who receive relatively little benefit from—and, therefore, have relatively little connection to—the taxing state, or overburdening smaller retailers with the regulatory costs of compliance. This approach would seem

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210. Other forms were more popular in earlier years. However, of the twenty-one states who have attempted to implement new e-commerce taxation schemes since 2015, over half have gone the way of economic nexus. *Id.*

211. Brian S. Masterson, *Collecting Sales and Use Tax on Electronic Commerce: E-Confusion or E-Collection*, 79 N.C. L. REV. 203, 214–15 (2000).

212. *Id.* at 214 (quoting Charles E. McLure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws,* 52 TAX L. REV. 269, 395 (1997)).

213. Quill Corp. v. Heitkamp *ex rel.* North Dakota, 504 U.S. 298, 307 (1992) (citing Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985)), *overruled by* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

214. Masterson, *supra* note 211, at 214.

to reflect a similar methodology to e-commerce taxation as the Marketplace Fairness Act of 2017.[215]

States implementing the economic nexus system, such as South Dakota, follow a basic model: they seek to impose sales and use taxes on remote retailers whose in-state sales exceed the *de minimis* threshold in a calendar year. States, however, have differed in their individual *de minimis* thresholds for imposing those taxes. Of the dozen or so states implementing the economic nexus system, most can be categorized as having one of two threshold requirements: (1) the lesser of $100,000 total in-state sales or 200 separate transactions or (2) $500,000 total in-state sales.[216] South Dakota's tax scheme provides a prime example of the former, while Tennessee models the latter.[217]

As discussed above, South Dakota's S. 106 requires that remote retailers collect and remit sales tax on "tangible personal property, products transferred electronically, or services for delivery into South Dakota" if they satisfy one of two requirements in the previous or current calendar year:

> (1) The seller's gross revenue from the sale of tangible personal property, any product transferred electronically, or services delivered into South Dakota exceeds one hundred thousand dollars; or
>
> (2) The seller sold tangible personal property, any product transferred electronically, or services for delivery into South Dakota in two hundred or more separate transactions.[218]

This *de minimis* threshold also reflects the approach of a significant number of economic nexus states.[219] For example, in late June of 2017, Maine passed an act requiring remote sellers to collect and remit sales and

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215. The Marketplace Fairness Act of 2017 would allow states to collect sales and use taxes on sales done by non-small-seller remote retailers. The most notable distinction is that, where many economic nexus states base their *de minimis* threshold on the amount of sales done in that *state*, the Marketplace Fairness Act of 2017 would base its small-seller exception to taxability on annual gross receipts in *total* U.S. remote sales. *See* Marketplace Fairness Act of 2017, S. 976, 115th Cong. (2017).

216. *See Remote Seller Nexus Chart*, *supra* note 209 (information may be accessed by clicking through each state's link under the 'economic nexus' column of the chart).

217. S.B. 106, 2016 Leg. Assemb., 91st Sess. (S.D. 2016); Tenn. Comp. R. & Regs. 1320-05-01-.129(2) (2017) [hereinafter "Rule 129"].

218. S.B. 106, 2016 Leg. Assemb., 91st Sess. (S.D. 2016).

219. Other states that have attempted to use this structure include Indiana, Maine, North Dakota, Rhode Island, and Vermont. *See Remote Seller Nexus Chart, supra* note 209.

use taxes on sales made into the state by retailers exceeding the $100,000 sales or 200 transactions *de minimis* threshold.[220]

Prior to *Wayfair*, a second category of economic nexus threshold was also making its way through the judicial system. In January 2017, Tennessee's Department of Revenue issued notice concerning its Rule 1320-05-01-.129(2) ("Rule 129"), which provides that remote retailers whose total sales to Tennessee customers in a 12-month period exceed $500,000 must collect sales tax for sales made in Tennessee.[221] Tennessee is one of several states utilizing the $500,000 threshold for imposing sales and use tax on internet retailers.[222] This regulation has also been challenged, not unlike the South Dakota regulation, though it did not make it to the Supreme Court. In March 2017, a lawsuit was filed in the Chancery Court of Davidson County, Tennessee, challenging the constitutionality of Rule 129.[223] An agreed order was subsequently entered on April 10, 2017, preventing the enforcement of Rule 129 until a final judgment could be made on the case.[224] The Tennessee General Assembly also passed legislation prohibiting the collection of any internet sales or use taxes authorized under 129 until the court's ruling had been reviewed and approved by the General Assembly.[225]

In light of *Wayfair,* it would seem that Rule 129 is likely to pass constitutional muster. It tracks closely with South Dakota's S. 106 in that it sets a sales threshold, but it is more generous with that threshold and does not offer the alternative of a number-of-transactions test.[226] However, it is unclear whether the Tennessee General Assembly, upon review of Rule 129, will choose to reinstate the rule or explore alternative options. The foregoing illustrates an interesting question for economic nexus states left open in the wake of *Wayfair*: how low can they go? States like Tennessee, with a higher economic *de minimis* than South Dakota's, might choose to lower their thresholds into line with South Dakota to capture more tax revenue. They

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220. *An Act To Require Remote Sellers To Collect and Remit Sales and Use Tax on Sales into Maine*, MAINE STATE LEGISLATURE, https://legislature.maine.gov/bills/displayps.asp?paper=SP0483&snum=128&PID=1456 (last viewed Sept. 15, 2017).

221. Rule 129, *supra* note 217.

222. Massachusetts has also proposed to use the $500,000 threshold. 830 ME. CODE R. § 64H.1.7. Ohio has also set a $500,000 threshold on taxing remote retailers, but it does so through a business-privilege tax. OHIO REV. CODE ANN. § 5751.01(I)(3) (West 2018). Interestingly, the Ohio Supreme Court held that the physical presence requirement outlined in *Quill* is restricted to sales and use taxes; it does not extend to a business-privilege tax like Ohio's, and accordingly, the tax was upheld as constitutionally sound. *See* Crutchfield Corp. v. Testa, No. 2015-0386, 2016 WL 6775765 (Ohio Nov. 17, 2016).

223. TENN. DEP'T OF REVENUE, NOTICE #17-12, OUT-OF-STATE DEALER REGISTRATION ENFORCEMENT DELAYED (May 2017).

224. *Id.*

225. *Id.*

226. Rule 129, *supra* note 217.

might also attempt to go lower. As discussed above, states using the economic nexus may even choose to forego a *de minimis* threshold altogether. While it is true that the threshold limits potential constitutional challenges for unduly burdensome tax schemes, nothing in the *Wayfair* decision expressly requires states to set one.[227] After *Wayfair*, states know that $100,000 in sales or 200 transactions is sufficient for nexus, but they cannot yet know if that threshold is *required* for nexus.

Regardless, however, of the many unanswered questions still circling economic nexus tax schemes in light of *Wayfair*, it is clear from the foregoing analysis that many states believe the economic nexus approach is the most promising way to accomplish their e-commerce taxation goals. The *Wayfair* decision only serves to bolster that conclusion. In its wake, states will likely begin, those that have not already, implementing their own economic nexus-based tax schemes to tap into the internet retail market.

### B. Affiliate and Click-Through Nexus

Although not as contemporarily popular as its economic counterpart, the affiliate nexus approach gained significant traction in the late 2000s and early 2010s.[228] To establish nexus, states using the affiliate nexus approach look to whether (1) an out-of-state retailer shares common ownership with an in-state retailer; and (2) the two entities operate a unitary business enterprise, generally for tax purposes.[229] Stated another way, if an affiliate of a remote retailer can be subjected to sales and use tax in a state, then the remote retailer may also be subject to sales and use tax in that state.

California's Assembly Bill 155 ("A.B. 155"), passed on September 9, 2011, is a prime example of how the system was implemented.[230] Under A.B. 155, an out-of-state retailer is considered to have substantial nexus for sales and use tax purposes if it "is a member of a commonly controlled group . . . and is a member of a combined reporting group . . . that includes another member of the retailer's commonly controlled group that" that performs services in the state on behalf of the out-of-state retailer.[231] Unfortunately, determining "affiliation" for purposes of nexus is an incredibly complex, multi-step process involving dueling principles of corporate formalities and economic realities,[232] the full nature of which is

227. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).
228. *Remote Seller Nexus Chart*, *supra* note 209.
229. Haile, *supra* note 102, at 1813.
230. *Id.* at 1814.
231. CAL. REV. & TAX. CODE § 6203 (West 2018).
232. For an in-depth analysis of affiliate nexus taxation, see John Swain, *Cybertaxation and the Commerce Clause: Entity Isolation or Affiliate Nexus*, 75 S. CAL. L. REV. 419 (2002).

beyond the scope of this note. Lower courts across the board have also tended to reject this approach to remote retail taxation.[233]

There is, however, an "offshoot" of affiliate nexus that avoids some of its problematic complexities while maintaining many of its practical effects: the click-through nexus approach. With click-through nexus laws, also known as "referrer nexus," a remote retailer can trigger sales and use tax liability by establishing business arrangements with an in-state entity that, for some sort of commission or consideration, refers potential customers to the remote retailer, typically through links on internet webpages.[234] This nexus approach is often combined with some form of economic nexus *de minimis* threshold, though the threshold is usually lower than the ones discussed in the economic nexus analysis above.[235] Again, after *Wayfair*, it is uncertain if a *de minimis* threshold is actually required.

A number of states, including California,[236] have explored this approach as a basis for imposing sales and use taxes on remote retailers.[237] Arguably, it requires fewer moving parts than its more Byzantine counterpart, affiliate nexus. The analysis centers around a singular contractual arrangement, as opposed to ongoing business relationships, corporate structures, and even combined tax reporting eligibility. However, as something of a trade-off for its more simplistic design, click-through application is inherently limited to the online solicitation of potential customers by in-state entities, while affiliate nexus could be more broadly applied. It also has not escaped the mire of judicial disapproval.

For example, Illinois enacted a click-through nexus provision through its House Bill 3659 in 2011. H.B. 3659 provided that a remote retailer could trigger tax liability by "having a contract with a person located in [Illinois] under which the person, for a commission or other consideration . . . refer[red] potential customers to the retailer by a link on the person's Internet website."[238] The provision was subsequently challenged, and in the 2013 case *Performance Marketing Ass'n, Inc. v. Hamer*, the Illinois Supreme Court found the provision to be void and unenforceable.[239] Attempts to utilize both the affiliate and click-through

233. Haile, *supra* note 102, at 1821.

234. David Gamage & Devin Heckman, *A Better Way Forward for State Taxation of E-Commerce*, 92 B.U. L. REV. 483, 518–19 (2012).

235. *Id.* at 519.

236. *See generally* Robert Ziegler, *California Enacts "Click-Through" and Affiliate Nexus Provisions Requiring Sales Tax Collection*, 22 ST. & LOC. TAXES WEEKLY, July 5, 2011, at 1, WESTLAW.

237. *Remote Seller Nexus Chart*, *supra* note 209.

238. H.B. 3659, 96th Gen. Assemb. (Ill. 2011).

239. The Illinois Supreme Court did not actually reach the issue of whether the click-through nexus provision was an unconstitutional abridgement of the Commerce Clause, nor did it address any abrogation of *Quill*. Rather, the Court found that the provision imposed a

nexus approaches to taxing remote retailers have dwindled in recent years. However, following *Wayfair*'s abolition of the physical presence requirement, such approaches could see a resurgence.

## C. Notice and Reporting Requirements

The preceding sections discussed states' various attempts to implement economic and affiliate nexus systems. Although there are significant differences between the two methods, they share at least one commonality: both are methods of directly imposing sales and use taxes on the remote retailers. They seek to bring the retailer within the taxing authority of the state and, accordingly, have come into conflict with constitutional and statutory principles of what constitutes a taxable, substantial nexus.

The notice and reporting requirements approach to collecting taxes from remote retail sales represents a fundamentally different way of accessing that revenue source. This approach focuses not on the imposition of sales tax, but on the effective collection of use taxes. A use tax is a tax imposed on the *use* of goods, rather than the purchase of goods, that are bought outside the taxing state.[240] Accordingly, rather than attempting to directly tax sales by the remote retailer, notice and reporting requirement laws seek to tax *use* of out-of-state goods and services by in-state consumers.[241] However, as the Court in *Wayfair* noted, "consumer compliance rates are notoriously low[.]"[242]

To combat compliance issues, states using this approach often require retailers to *notify* consumers about their use tax obligations on purchases not subject to the states' sales tax.[243] Some states also require that remote retailers provide *reports* of all sales made into that state for which sales tax was not collected.[244] Thus, "notice and reporting" requirements. In

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discriminatory tax on electronic commerce, which violated an independent provision of the federal Internet Tax Freedom Act. *See* Performance Mktg. Ass'n, Inc. v. Hamer, 998 N.E.2d 54, 59 (Ill. 2013). This could illustrate another potential complication for states seeking to implement the click-through nexus system: while the physical presence requirement of *Quill* is no longer an impediment to taxing remote retailers, other areas of federal law have been found to preempt the application of click-through nexus. Such other laws could, as the Court in *Wayfair* alluded to, be grounds to invalidate e-commerce taxation provisions. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018) ("The question remains whether some other principle in the Court's Commerce Clause doctrine might invalidate the Act.").

240. *Use Tax*, BLACK'S LAW DICTIONARY (10th ed. 2014) (emphasis added).

241. *Remote Seller Nexus Chart*, *supra* note 209.

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

243. Adam Ondo, *A Solution to Use Tax Avoidance: Transaction Reporting Requirements for Remote Sellers*, 49 TEX. TECH L. REV. ONLINE ED. 77, 92 (2017).

244. *Id.*

theory, this approach allows the states to access some of the revenue from remote retail sales without attempting to directly impose tax on remote retailers. In the past, doing so allowed them to avoid the physical presence requirements set forth in *Quill* altogether.

In practice, the application is not so neat. Take, for example, the notice and reporting requirements that Colorado effectuated in 2010. Codified in Colorado Revised Statute Annotated § 39-21-112(3.5)(c)-(d), the requirements provide the following for sales to Colorado purchasers on which Colorado sales tax was not collected: (1) retailers must notify Colorado purchasers "that sales or use tax is due on certain purchases made from the retailer"; (2) retailers must notify Colorado purchasers "the total amount paid by the purchaser for Colorado purchases made from the retailer in the previous calendar year"; and (3) retailers must file annual statements for *each purchaser*, reporting the total amount of sales to those purchasers in the previous calendar year.[245] Failure to provide the notice under (1) will subject the retailer to a five dollar penalty per failure, while failure to provide the report under (3) will subject the retailer to a ten dollar penalty per failure.[246]

This provision of Colorado tax law was challenged in *Direct Marketing Association v. Huber* ("*Huber*") on the grounds that the notice and reporting requirements discriminated against and imposed undue burdens on interstate commerce.[247] The United States District Court for the District of Colorado agreed, citing *Quill* for the proposition that "a state law that imposes a use tax collection burden on a retailer with no physical presence in the state causes an undue burden on interstate commerce."[248] On appeal, however, the United States Court of Appeals for the Tenth Circuit thought otherwise, even while *Quill* was still considered good law.[249] In *Direct Marketing*, the Tenth Circuit explained, "Quill applies narrowly to and has not been extended beyond tax collection."[250] And because the Court found the notice and report requirements to be separate from the collection and remission of taxes, it held that the Colorado law did not violate the Commerce Clause, nor did it conflict with the Supreme Court's holding in *Quill*.[251]

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245. COLO. REV. STAT. ANN. § 39-21-112(3.5)(c)–(d) (West 2017).

246. *Id.*

247. Direct Mktg. Ass'n v. Huber, No. 10-CV-01546-REB-CBS, 2012 WL 1079175, at *3 (D. Colo. Mar. 30, 2012), *rev'd sub nom.* Direct Mktg. Ass'n v. Brohl, 814 F.3d 1129 (10th Cir. 2016).

248. *Id.* at *9.

249. Direct Mktg. Ass'n v. Brohl, 814 F.3d 1129, 1139 (10th Cir.), *cert. denied*, 137 S. Ct. 591 (2016), *and cert. denied*, 137 S. Ct. 593 (2016).

250. *Id.*

251. *Id.* at 1144.

The *Direct Marketing* line of cases draws attention to an issue of central importance to notice and reporting requirements: discrimination against interstate commerce. The issue is more pronounced with this approach to taxation, as opposed to economic nexus and affiliate nexus, where the state seeks simply to impose the same sales tax on both in-state and out-of-state retailers. Here, because the notice-report requirements focus primarily on *use* tax from retailers that do not collect sales tax—particularly in states where local retailers are obligated to pay *sales* tax, and are thus not subject to the requirements—the burdens would seem to fall more heavily on remote retailers.[252] This was the district court's primary basis for determining that the Colorado law violated the Dormant Commerce Clause.[253] But, as the Tenth Circuit pointed out in overruling the district court's decision, imposing the requirements served a more equifinal purpose: they effectively sought to put all businesses, in-state and out-of-state, on equal footing.[254]

In theory, so long as a state can maintain this balance, its notice-report requirements will not violate constitutional protections for interstate commerce. States may endeavor to do so in a number of ways, such as compensating retailers for the cost of complying with the notice-reporting requirements,[255] since many states already offer compensation for the cost of complying with sales and use tax collection requirements.[256] States should also take steps to streamline the process for out-of-state retailers, and methods for doing so may include some of the following: making "form" notices readily available to out-of-state retailers, listing those purchases eligible for use tax exemptions,[257] and for those states that collect a resident income tax, including a line on income tax returns on which residents report use tax dues.[258]

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252. *Id.* at 1140.

253. *Id.*

254. *See generally id.*; *see also* Ondo, *supra* note 243, at 98.

255. Ondo, *supra* note 243, at 101.

256. Ondo also recommends that states provide an exception for small-sellers, such as those making less than $100,000 in sales to in-state purchasers. *Id.* This use of what is effectively a *de minimis* threshold for tax liability further lessens the burdens of notice and reporting requirements on out-of-state retailers.

257. Colorado's provision includes language about including use tax exemptions on the notice to consumers "if known by the retailer." COLO. REV. STAT. ANN. §39-21-112(3.5)(d)(I)(A) (West 2017).

258. The United States District Court for the District of Colorado suggested this as an alternative to notice-reporting requirements. Direct Mktg. Ass'n v. Huber, No. 10-CV-01546-REB-CBS, 2012 WL 1079175, at *6 (D. Colo. Mar. 30, 2012, *rev'd sub nom*, Direct Mktg. Ass'n v. Brohl, 814 F.3d 1129 (10th Cir. 2016). However, it could also be used to supplement the notice requirements imposed on retailers, thus shifting some of the burden from the retailers to the state and consumers.

Colorado represents the successful maintenance of this precarious balance. Unfortunately, even the successful application of this approach may be subject to criticism given the "impracticability" of the collection of use taxes.[259] States must rely on their residents to pay the use taxes owed on their purchases from remote retailers,[260] and "consumers regularly fail to comply with lawful use taxes."[261] This shortfall may have contributed to the lost revenue reported by states under *Bellas Hess* and *Quill*.[262] Accordingly, with the physical presence requirement laid to rest and greater options for *sales* tax imposition available, it is questionable how many states would choose to keep their sales and use tax income eggs squarely in the use tax basket.

Of course, it is also important to note that the three approaches described above do not exist in a vacuum, and they are not mutually exclusive. Although some states may choose to use purely economic nexus, purely affiliate nexus, or purely notice-report requirements in their respective taxation schemes for e-commerce sales, other states may choose to employ a combination of the various methodologies.[263] Rhode Island's House Bill 5175, for example, utilizes all three approaches to collecting sales and use taxes from remote retailers.[264]

Certainly, some approaches have been utilized more than have others, and some have seen more success in their utilization. Additionally, there are different ways of implementing each approach that may yield different results. With that in mind, the next section will offer a model provision, illustrating an approach that seeks to capture the most advantages for states' tax schemes, while including the fewest practical and legal deficits. The benefits of each provision will be discussed as well.

## V. MODEL PROVISION FOR STATE E-COMMERCE TAXATION SCHEMES

Between growing e-commerce sales, the modern decline of brick-and-mortar retailers, and the overall importance of sales and use tax revenue to state funding schemes, states are highly motivated to find innovative ways to access the e-commerce market. And with the fall of the physical presence requirement, new doors have opened for states' sales and use tax schemes. The question then becomes *how* states should go about taxing remote retailers to both maximize benefits for all parties and avoid constitutional challenge.

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259. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2088 (2018) (quoting Nat'l Geographic Soc'y. v. Cal. Bd. of Equalization, 430 U.S. 551, 555 (1977)).

260. *Id.*

261. *Id.* at 2098.

262. *Id.* at 2088.

263. *Remote Seller Nexus Chart*, *supra* note 209.

264. H.B. 5175, Gen. Assemb., Jan. Sess. 2017, (R.I. 2017).

As explained in earlier sections, the fall of *Quill* means the demise of the bright-line physical presence requirement for establishing substantial nexus. It also means the beginning of a new question: If not physical presence in the taxing state, what *does* constitute a substantial nexus for sales and use taxation purposes? In the wake of *Wayfair*, the Supreme Court appears to have offered at least one potential answer to that question. Given the Court's approval of the economic nexus approach in South Dakota, as well as the rapid expansion of the economic nexus across the states, a seller's economic contacts with the taxing state is likely the best approach to taxing e-commerce.[265] Accordingly, a retailer's sales tax liability in a certain state may be predicated on the amount of taxable sales it makes to consumers in that state.

This approach also gained some strong footing in early academic discussions of the topic, and—when coupled with a *de minimis* exemption for small-sellers—is the approach that would seem to produce the most consistent, neutral impact on interstate commerce.[266] It bases tax liability not on economically impractical measures like physical presence, or complex determinations of agency; rather, it centers wholly around the simple premise that taxable activity within a state—above a certain *de minimis* threshold—creates tax liability in that state.[267] In doing so, it calls for a fundamentally equivalent treatment of in-state retailers and out-of-state retailers:

> [A] person with physical presence in a state or that sells goods, whether tangible or intangible, or services for delivery in a state where they are subject to sales or use tax should be under the sales/use tax jurisdiction of that state, unless such sales to a particular state are *de minimis*. Similarly, a person that has a physical presence in the state or that conducts activities in a state that are factors in the formula the state uses to apportion income among the states (commonly payroll, property, and sales) should be subject to the income tax jurisdiction of that state, unless such activities in the state are *de minimis*.[268]

While the balance is ultimately complicated by outside factors, it must be said that the economic nexus approach at least provides a strong starting point for a new, consistent understanding of substantial nexus.

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265. *Remote Seller Nexus Chart*, *supra* note 209.

266. "Nexus should be predicated on the presence of taxable activity in the taxing jurisdiction[,]" and "[n]exus should not exist in jurisdictions where otherwise taxable economic activity is de minimis." McClure, *supra* note 185, at 392.

267. Masterson, *supra* note 211, at 214.

268. McClure, *supra* note 185, at 395–96.

To avoid "tipping the scales" in favor of in-state commerce, thus inviting constitutional challenges under the Dormant Commerce Clause, states should consider a number of things. The first is that the economic nexus approach is inherently more suited to a state with a destination-based tax system, as discussed in greater detail above.[269] Accordingly, states like Tennessee whose sales tax is not necessarily determined by the destination or ultimate consumption of a good should consider adopting a destination-based system, at least for purposes of e-commerce taxation. Failure to do so may result in challenges under the Commerce Clause, as well as an increased burden for remote retailers.

The second recommendation pertains to the *de minimis* threshold for imposing tax liability on remote retailers. As a preliminary matter, while the Supreme Court has not expressly required a *de minimis* threshold, states should strongly consider implementing one in their own tax schemes. This would help minimize the burden on smaller retailers and would also ensure that there are, in fact, substantial contacts with the state sufficient to create a taxable nexus.

Once a state has decided to set a *de minimis* threshold, the question then becomes how the threshold should be calibrated. States employing the economic nexus system have tended to base their *de minimis* threshold on the amount of sales *into the state*, rather than the retailer's aggregate national sales.[270] The former is a better method than the latter, notably because it prevents retailers from being subject to taxation in states where they do relatively little business; the state-sales model more closely reflects the actual, substantial *nexus* with the taxing state, which is now the standard under *Wayfair*.[271] Higher *de minimis* amounts are less likely to face constitutional challenge on nexus grounds, but the Supreme Court has accepted a $100,000 sales or 200 separate transactions threshold, so that provides a strong starting point.[272] Additionally, the Supreme Court did not approve that threshold as a minimum for substantial nexus, so the *de minimis* threshold could theoretically be lower. In sum, the second recommendation for taxing remote retailers would be that the *de minimis* threshold be based on sales *into the state*, and be set at $100,000 in sales or 200 separate

269. *See supra* Section III.b (defining "destination-based tax system" and explaining the need for such a system under an economic nexus approach to e-commerce taxation).

270. The "amount" of sales can refer to either the number of separate transactions, or the total value of sales into the states. For example, Maine's regulation would set the *de minimis* threshold at $100,000 total sales or 200 separate transactions. S.P. 483, 128th Leg., 1st Reg. Sess. (Me. 2017). Tennessee, on the other hand, sets its *de minimis* threshold purely at $500,000 total sales. Rule 129, *supra* note 217.

271. McClure, *supra* note 185, at 400.

272. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018).

transactions,[273] to avoid constitutional challenge and avoid unduly burdening small retailers with the high costs of compliance.

Third, states should include language prohibiting the retroactive application of any internet retail taxation schemes they enact. While it's true that *Wayfair* did not expressly preclude retroactivity in e-commerce sales and use taxation, the Court recognized that the prospective nature of South Dakota's S. 106 was a form of protection from undue burdens of taxation, particularly for small retailers.[274] Furthermore, in addition to creating "massive exposure for retailers that never collected sales or use tax," retroactive application would run afoul of significant reliance concerns.[275] Retailers, acting in "reasonable reliance on *Quill* and its predecessor, *National Bellas Hess*," have not been collecting sales and use tax on sales made into states where those retailers do not have a physical presence.[276] To retroactively make those retailers liable for sales and use tax on those sales would impose upon them a significant, unpredicted cost, as well as potentially impose double tax burdens for the same transaction.[277] Fortunately, in *Wayfair*, forty-one states joined to file an amicus curiae brief wherein they "provided assurances to the U.S. Supreme Court that retroactive application of any new decision would be unlikely and limited."[278] Even states that did not join should consider the relative merits of a prospective-only application.

Fourth and finally, a system of taxing remote retailers would benefit from uniformity across the states.[279] This is especially true of e-commerce taxation because of the inherently borderless nature of the internet. Sellers from Washington may be on the same webpage as sellers from Florida; purchasers from Hawaii may browse the same online stores as purchasers from New York. There would seem to be something innately nonsensical about imposing different nexus requirements on such a ubiquitous form of retail. That is not to say state tax *rates* would have to be similar[280] or even that their apportionment methods would have to be the same across state lines. By simply embracing the same economic nexus approach and *de*

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273. A higher threshold would likely also be approved by the courts, while a lower threshold runs the risk of invalidation for an insufficient nexus with the taxing state.

274. *Wayfair*, 138 S. Ct. at 2098.

275. Zach Gladney & Charles Wakefield, *'Wayfair': What Are the Practical Retroactivity Concerns?*, BLOOMBERG BNA (July 19, 2018), https://www.bna.com/insight-wayfair-practical-n73014477734/.

276. *Id.*

277. *Wayfair*, 138 S. Ct. at 2099.

278. Gladney & Wakefield, *supra* note 275.

279. McClure, *supra* note 185, at 277.

280. The make-up of state tax revenue systems is too dissimilar for that to be practical. For example, a state with no income tax might need a higher sales and use tax rate to compensate for the revenue *not* gained through income tax.

*minimis* threshold, states could establish a more consistent marketplace for internet retailers and their customers.[281] This uniformity is especially helpful for states that, unlike South Dakota, are not party to the SSUTA. Given the costs and administrative challenges of collecting and remitting sales and use tax across more than 10,000 taxing jurisdictions across the 50 states, failure to find some common ground could deal a painful, if not fatal, blow to many internet retailers.

The following is a model provision for the imposition of sales and use tax on remote internet retailers after *Wayfair* drafted by the Author with the foregoing four considerations in mind:

> **Model: Sales and Use Tax Liability for Out-of-State Retailers**
>
> (a) Out-of-state retailers will be deemed to have a substantial nexus with this State if they engage in regular or systematic solicitation of customers in this State through any means and either (i) made sales to consumers in this State from which gross revenue exceeds one hundred thousand dollars ($100,000) or (ii) completed two hundred (200) or more separate transactions for the delivery of tangible personal property, products transferred electronically, or services into this State during the previous or current twelve-month period.
>
> (b) Out-of-state retailers having such substantial nexus with State as described in subsection (a) of this provision shall register with the State department of revenue for sales and use tax purposes and shall collect and remit the appropriate tax to the Department on sales of tangible personal property and other taxable items delivered to consumers in this State.
>
> (c) Persons who purchase tangible personal property or other taxable items from any out-of-state retailer as described in subsection (a) must pay State sales and use tax to the retailer, unless the sale is otherwise exempt under the laws of this State.

281. Federal legislation like the Marketplace Fairness Act may also be helpful in setting more standardized guidelines for remote e-commerce taxation.

> (d) No obligation to collect and remit the State sales tax required hereby may be applied retroactively.

The individualized nature of states' sales and use tax schemes makes it difficult to offer a singular method of implementing this change. Some will require statutory changes; others may promulgate rules through the appropriate regulatory body. The purpose of this model is only to serve as an illustration of how the economic nexus approach may be implemented in the future, with its *de minimis* threshold and new categorization of substantial nexus. It may provide aid for states seeking to collect sales and use taxes on remote e-commerce without impeding interstate commerce, should *Quill* no longer control the field.

## CONCLUSION

The retail landscape is changing. With e-commerce on the rise, it is increasingly vital that states find ways to innovate and adapt their tax systems to the contemporary marketplace without hampering the growth of that marketplace. Following *Wayfair*, and in the lingering silence of Congress, states will experience new freedoms in e-commerce taxation as the focus shifts from physical presence to other, perhaps yet unimagined means of establishing a substantial nexus. There are now multitudinous options at their disposal by which to supplement their current revenue sources and adapt to the changing retail landscape.

It bears mentioning that the ultimate wisdom of imposing sales and use taxes on e-commerce is tremendously complex and beyond the scope of this note. Rather, this note is intended to address the impacts of *Wayfair*, including those stemming from issues it resolved as well as those it left unsettled, and to provide guidance for states looking to adapt their tax schemes to the current environment of e-commerce taxation. As discussed above, such adaptations should strive to strike a balance between maximizing revenue and minimizing the burden upon remote retailers. Failure to do so may irreparably harm the very marketplace states seek to gain advantage from. Success, however, may serve to finally contemporize internet retail taxation with today's commercial reality.