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

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BACKGROUND

Wayfair, Inc., Overstock.com, Inc., and Newegg, Inc., (collectively "Respondents") are all major online retailers that operate throughout the United States. Wayfair and Overstock.com are both online retailers that sell home goods. Their 2017 net revenues were more than $4.7 billion and $1.7 billion respectively.[1] Newegg, also an online retailer, features electronics. Respondents neither have employees nor real estate in South Dakota.

Petitioner South Dakota, like most states, imposes a sales tax on the retail sales of goods and services within the state. Generally, merchants must collect and remit the tax to the state's Department of Revenue. However, in cases where the merchant operates out of state, the duty to add and report the tax to the Department falls on consumers residing in the state. This policy affects state revenues, given the notoriously low consumer compliance rates.

The Supreme Court, in *Bellas Hess* and *Quill*, had previously established that states cannot force a company to collect that state's sales tax if the company lacks a physical presence in the state.[2] South Dakota estimated an annual revenue loss of $48 million to $58 million in taxes, which could have been used to fund essential needs and services to state residents.[3]

In 2016, South Dakota's legislature declared a state of emergency because it found that the state's inability to collect taxes from online sales was causing considerable revenue losses and harm was imminent. Hence, in order to correct the "physical presence" disparity caused by *Quill*, it enacted the Emergency Act, Senate Bill 106 (the "Act").[4] The Act required out-of-state companies to collect and remit sales tax if the company, while conducting business out of South Dakota, delivered an amount worth greater than $100,000 into the state in a year; or had 200 or more separate transactions for delivering goods and/or services in the state annually.[5] The constitutionality of the Act and the applicability of the physical presence rule of *Quill* were at issue in this case.

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1. South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2089 (2018).
2. National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753 (1967); Quill Corp. v. North Dakota, 504 U.S. 298 (1992).
3. *South Dakota*, 138 S. Ct. at 2088.
4. *Id.*
5. *Id.* at 2089.

PROCEDURAL HISTORY

South Dakota filed for a declaratory action in the state court for a determination that the requirements under the Act are valid and that they can be applied to Respondents. The state also sought an injunction compelling Respondents to collect and remit sales taxes. The Respondents replied with a summary judgment motion, which the trial court granted. The South Dakota Supreme Court affirmed the trial court's summary judgment ruling in favor of the Respondents holding that the Act was unconstitutional and Quill still remains to be the governing precedent. The U.S. Supreme Court granted certiorari to review the applicability of previous holdings in *Bellas Hess* and *Quill.* The necessity stemmed from the contention that commerce currently operates in the Cyber Age, and, as a result, past decisions do not connect with present economic realities.

ISSUE

The Supreme Court of the United States was asked to determine whether companies must satisfy the physical presence rule in order to be subject to a state's laws requiring the companies to collect and remit state taxes.

DECISION

SCOTUS vacated the judgment of the Supreme Court of South Dakota and remanded for further proceedings after overturning the physical presence rule of *Quill* and determining that it was outdated and incorrect. Given the expansion of e-commerce and the Act's narrow applicability—to sellers who engage in a significant amount of business in the state—the physical presence rule should not limit South Dakota's sovereign power to seek long-term prosperity.

REASONING

The Court first began with an overview of the evolution and expansion of the Commerce Clause. Two primary principles have developed regarding a state's authority to regulate interstate commerce under the Commerce Clause: (1) state laws cannot discriminate against interstate commerce; and (2) state laws cannot place an undue burden on interstate commerce.[6] These principles influenced a test to determine the validity of a state's tax regulation which is explained in *Complete Auto*,[7] and which the Supreme Court finds as an accepted framework. According to *Complete Auto*, a state sales tax is valid if it (1) applies to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the state provides."[8]

6. *Id.* at 2091.
7. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).
8. *South Dakota*, 138 S. Ct. at 2091.

Next, the Court analyzed the physical presence rule and its role in the *Complete Auto* test's first prong. The Court acknowledged the advantage out-of-state sellers have under the physical presence rule and *Quill*'s incorrect interpretation of the Commerce Clause. Specifically, *Quill* creates an incentive for sellers to avoid physical presence in multiple states, and it treats economically identical actors differently for arbitrary reasons. The Court also considered the reality of modern-day economies. It held that a court should not uphold a rule that ignores the substantial virtual connections a seller can have to a state using the marketing and distribution functions of e-commerce. The outdated physical presence rule provided an arbitrary advantage to some online retailers over in-state competitors who had to collect sales taxes. A states' ability to seek long-term prosperity was ultimately restricted by the physical presence rule's limits on the collection of state sales taxes.

Finally, the Court applied the *Complete Auto* test to South Dakota's tax law and determined that the Act met the test's first prong, which looked at whether the activity being taxed had a substantial nexus with the taxing state. The fact that Respondents each earned at least a million dollars in net revenue from sales made within the South Dakota showed the sellers engaged in a significant quantity of business in the state, and it showed the sellers were large companies with an extensive virtual presence. However, the Court found that the lower courts have not yet reviewed the other prongs of the test, and hence remanded the case for further proceedings.

DISSENT: JUSTICE ROBERTS

Chief Justice Roberts, joined by Justices Breyer, Sotomayor, and Kagan, dissented for two reasons. First, *stare decisis* has a higher standard when attempting to rule on matters of primary concern to Congress, i.e. interstate commerce. The dissent claimed the standard was not met in this case. Second, the dissent highlighted that Congress was the appropriate entity to fix the past mistake through legislation and that the Court had already advised Congress to fix the problem twice, in *Bellas Hess* and *Quill*. The dissent felt that Congress' failure to immediately address this problem meant that the Court had a duty to uphold the physical presence requirement it had previously established until Congress decides what to do.