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Supreme Court Ruling Scrambles Online Retailers

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Online retailers took a sizable hit Thursday morning with the Supreme Court's landmark decision in *South Dakota v. Wayfair*.

The 5-4 ruling in favor of South Dakota, which applies to thousands of such businesses, allows states to require them to collect and remit state sales taxes for internet transactions. It overturns the court's 1992 decision in *Quill v. North Dakota*, which restricted states from collecting sales tax from retailers that didn't have a physical presence there.

Many other states, perhaps most of them, likely will now adopt a South Dakota-style law of their own, according to Paul Graney, state and local tax leader for law firm Marcum LLP.

Jeffrey LeSage, Americas vice chairman, tax, for KPMG, articulated the ruling's likely profound effects: It "could turn out to be almost as significant for American businesses as the recent rewrite of the U.S. federal tax code," he stated. "It's a decision that reflects the realities of an increasingly digital economy."

LeSage continued, "The impact of the court's ruling on companies in terms of time, technology, and expense is likely going to be substantial. Businesses will now need to closely examine and retrofit their operations to determine where they have to collect tax, whether their goods are taxable, and how they are going to handle the new tax computation, filing, and remittance obligations."

Eschewing a physical presence test, South Dakota and a few other states had adopted an economic threshold test for determining a retailer's liability for collecting and remitting state sales tax.

In South Dakota, the law applies to online retailers with annual sales of \$100,000 in the state or at least 200 transactions in the state. States with higher thresholds, such as Alabama and Tennessee, can keep their laws in place.

The **court ruling** doesn't prevent states from adopting lower economic thresholds, but Graney says he doubts states will go in that direction.

“Most of them will say that the difference between a \$100,000 threshold and, say, a \$50,000 threshold is not enough to care about,” he says. “States are looking for big money from big companies.”

The ruling also creates a slight competitive uptick for brick-and-mortar sellers, as it eliminates a slice of the pricing advantage that online retailers have enjoyed. But the impact will be minimal at most, as goods are generally much cheaper when bought online regardless of sales taxes.

In recent years, many states have **adopted laws** designed to get around the *Quill* decision. About 20 states have a “click-through” nexus, meaning that a company is deemed to have a physical presence in a state if it advertises on the website of a company that does have such a presence.

About 10 states — including some of those 20 — have notice-and-reporting laws. They require companies selling through marketplace facilitators such as Amazon.com and Walmart.com to either collect and remit state sales tax or to annually notify customers that they may owe use tax or provide the state with a list of their customers so that the state can go after them.

(Most states have laws requiring residents to pay use taxes on internet purchases, but they are almost impossible to enforce absent notice-and-reporting measures.)

For the most part those workarounds have been on hold while states waited for a decision in the *Wayfair* case. Now they’re likely consider the workarounds “more trouble than they’re worth” and abandon them in favor of a South Dakota-style economic threshold test, says Graney.

However, the Tax Foundation warns that “this ruling is not a blank check for states. The court specifically observed that South Dakota’s law minimizes the burden on interstate commerce. Other states should craft their laws accordingly.”

The majority opinion written by Justice Anthony Kennedy detailed several features of South Dakota’s law designed to ease that burden, including an assurance that “no obligation to remit the sales tax may be applied retroactively.”

According to Graney, Congress should act to standardize and clarify the economic thresholds that establish **nexus for states** to require online retailers to collect and remit sales taxes. Otherwise, he says, companies likely will initiate more litigation.

Graney does not, however, expect Congress to get involved.

“When the *Quill* decision was put out in 1992, the intention was for Congress to step up with rules,” he says. “But Congress is loath to address this tax law, because there’s no political benefit. If you vote to limit the law, people will say you’re in the pockets of business. If you do something to make the law [tougher], you’re a tax-and-spend liberal.”

The court ruling does not prevent online retailers from bringing other challenges to the South Dakota law in lower courts. But Jamie Yesnowitz, state and local national tax leader for Grant Thornton, says he doesn’t see much likelihood of such challenges being brought or succeeding.

Bob Peters, managing director, tax risk advisory, for **Duff & Phelps**, notes that the ruling “will create a rush of new capital investment for tax compliance software and allocation of resources to collect, remit, and file [state] sales tax.”