KNAV
PARTNERS BEYOND BOUNDARIES

Shishir Lagu
Partner- US Taxation

US TAX

June 2018

SOUTH DAKOTA V/S WAYFAIR INC: LANDMARK DECISION IMPACTING US SALES TAX LANDSCAPE

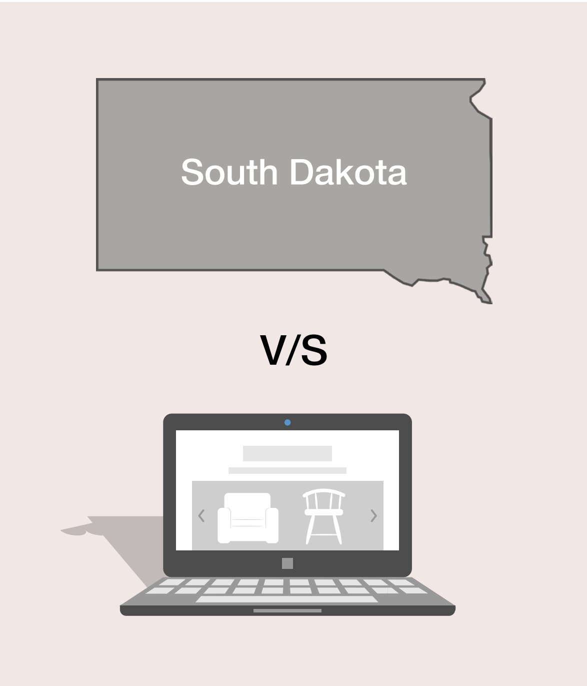
On June 21, 2018, the Supreme Court issued its decision in the case of South Dakota v. Wayfair, Inc. This decision is being looked upon as a landmark decision which will have a profound effect on taxation of out-of-state especially online sales across the country.

BACKGROUND:

Sales Tax is a transactional tax on the in-state sale of tangible personal property. A use tax is a compensating tax imposed by states to collect taxes on sales which do not take place in their state. The tax is meant to ensure that all purchases are taxed, whether purchased locally or from out of state sellers.

Sales Tax can be imposed on seller or, on buyer and collected by seller. The use tax is usually the customer's responsibility to pay. Both the Due Process Clause and the Commerce Clause of the United States Constitution limit the state's power to impose sales taxes or a use tax collection obligation on an out-of-state vendor, including an internet vendor. Both of these constitutional limitations come into play, when dealing with interstate sale transactions, and limit a state's ability to impose a sales tax or use tax collection duty on an interstate sale transaction. Accordingly, the vendor has a right to collect use tax in case of an interstate sale only if the vendor has "nexus" to the state of purchaser. In a landmark decision in 1992, the U.S. Supreme Court ruled in Quill Corporation v. North Dakota (504 U.S. 298) that a company will generally have nexus for sales and use taxes when it has more than a "de minimis" physical presence in a state (i.e., in-state property, employees, contractors, sales reps). A taxpayer having substantial nexus in a state is only required to register with the state sales and use tax department and collect sales or use tax, as applicable.

This decision in Quill Corporation over the years caused significant hurdle for states in imposing sales and use tax on out-of-sellers causing a huge loss of revenue. Over the years, lot of the states (31 states till date) have enacted laws challenging the Quill Corporation. Some states have introduced economic nexus norms, generally based on sales value and number of transactions (most of these have become effective in 2017 or 2018), some have imposed notice and reporting requirements, while some states have moved to click through nexus norms in line with New York. The diagrammatic representation of how states have adopted these new standards for internet sales is presented in Exhibit 1.



US SUPREME COURT RULING IN CASE OF SOUTH DAKOTA V. WAYFAIR, INC

The US Supreme Court on June 21, 2018 delivered a judgement in Wayfair case overturning the 1992 Quill Corporation decision. It held that the states can compel out-of-state retailers to collect sales taxes even if they don't have a physical presence in the state. Writing for the majority in the 5-to-4 ruling, Justice Anthony M. Kennedy said the Quill decision caused states to lose annual tax revenues of up to $33 billion. Few noteworthy remarks made by the Supreme Court while delivering this judgement are:

The current law effectively incentivized businesses to "avoid physical presence" in states and led to "a judicially created tax shelter."

The court cited the argument of Walter Hellerstein, co-author of the WG&L treatise "State Taxation", that "while nexus rules are clearly necessary", the Court "should focus on rules that are appropriate to the twenty-first century, not the nineteenth."

Additionally, The South Dakota v. Wayfair ruling struck an appropriate balance, recognizing states' interests in applying their sales tax equally, but acknowledging that state sales tax rules are a mess that could still burden interstate commerce. South Dakota's law is uniquely simple and includes an exemption for smaller sellers, thereby minimizing the interstate commerce impact of compliance. This ruling is clearly not a blank check for all states. Other states seeking online sales tax collection authority should craft their laws accordingly.

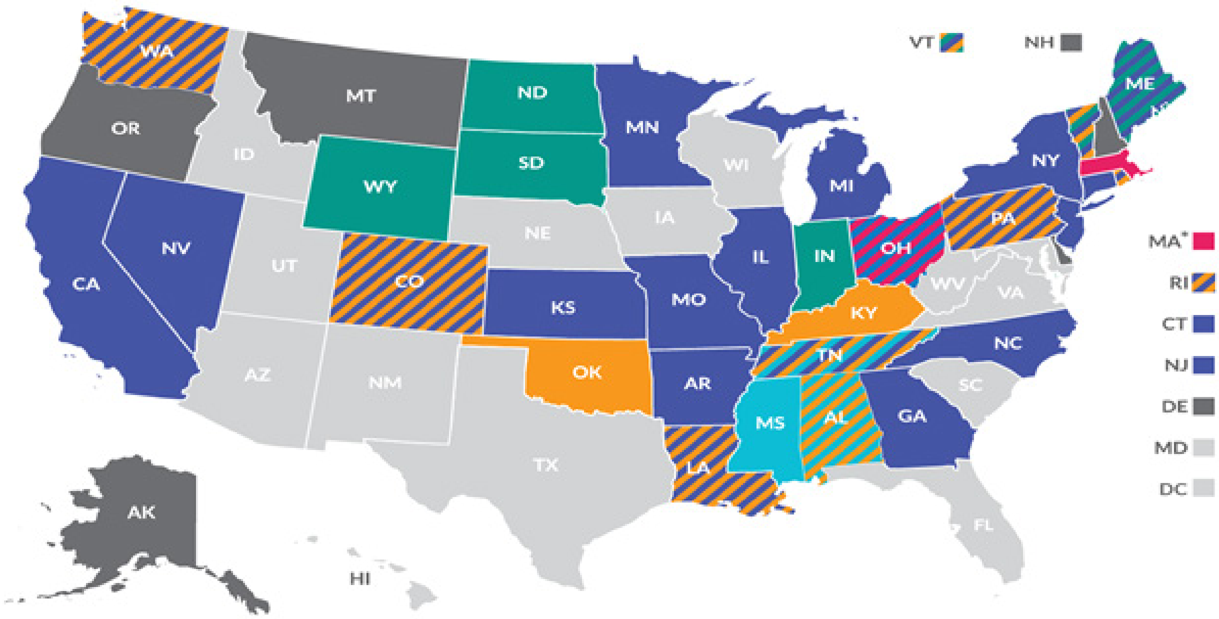
IMPACT OF THIS NEW DECISION:

Many states that felt a pinch due to the Quill Corporation decision, see this new decision as a welcome sign for the states to move away from physical nexus standard. What this means:

1. It strengthens the case for 31 states (Exhibit 1) which have already enacted laws moving away from physical nexus. This decision will help states in certain ongoing cases against it for enacting economic nexus law example: Newegg Inc. filed the first appeal challenging Alabama's regulation, and the case is still ongoing.
2. Certain states have issued regulations providing for economic nexus norms, but the provisions to become effective only upon overturning of Quill Corporation decision, which has now happened in Wayfair. These states will now immediately move to economic nexus rule and subject the out-of-state taxpayers to collection of sales tax in such states once certain threshold limits are met. Examples:
   (a) ND legislation 2017 N.D. S.B. 2298 only becomes effective if the United States Supreme Court overturns its decision in Quill Corp. v. North Dakota, or issues a decision confirming a similar provision in another state.
   (b) Vt. Stat. Ann. tit. 32, §9701(9)(F)(ii), as amended by 2016 Vt. H. 873, §26, is effective the later of July 1, 2017, or the first day of the first quarter after a controlling court decision or federal legislation abrogates the physical presence requirement of Quill Corp v. North Dakota.
3. States that have hitherto not addressed the issue beyond physical nexus standard, may rush to enacting laws to effect the shift.

Undoubtedly, the Wayfair decision will have a huge impact on sales taxability in the US requiring businesses to reassess their nexus analyses

31 STATES TAX INTERNET SELLERS WITHOUT PHYSICAL PRESENCE



Note: (*) Regulation withdrawn and reproposed

- Physical Presence
- New York Style "click-through" nexus
- Colorado-style notice-and-reporting
- Alabama-style economic nexus
- No state sales tax
- South Dakota-style threshold law
- Cookie nexus

KNAV
PARTNERS BEYOND BOUNDARIES

KNAV refers to one or more member firms of KNAV International Limited ('KNAV International'); which itself is a not-for-profit, non-practising, non-trading corporation incorporated in Georgia, USA. KNAV International is a charter umbrella organization that does not provide services to clients. Each firm within KNAV's association of member firms, is a legally separate and independent entity. Services of audit, tax, valuation, risk and business advisory are delivered by KNAV's independent member firms in their respective global jurisdictions.

All member firms of KNAV International in India, North America and UK are a part of the US$ 2.01 billion, US headquartered Allinial Global; which is an accounting firm association, that provides a broad array of resources and support for its member firms, across the globe.

For expert assistance, please contact **Shishir Lagu** at: shishir.lagu@knavcpa.com or +91 98190 13046

Visit us at: www.knavcpa.com

Head office: 303 OIA House, Cardinal Gracious Road, Andheri E, Mumbai 400099, India
Other offices: Amsterdam | Bengaluru | Geneva | Hyderabad | London | Lyon | New Delhi | Singapore | Toronto