



## Updated Rules For Online Sales Tax Collection

On June 21, 2018, the United States Supreme Court issued its opinion in the case of *South Dakota v. Wayfair, Inc.* (*Wayfair*), which is of critical importance to e-commerce retailers and other multi-state businesses that sell products that are subject to sales and use tax ("SU tax").

### Background

Under the Commerce Clause of the U.S. Constitution, the Supreme Court has ruled that a state may tax an activity only if the activity has a "substantial nexus" with the state. In the SU tax context, the Supreme Court (in the cases of *National Bellas Hess, Inc. v. Department of Revenue of Illinois* [*National Bellas Hess*], 1967 and *Quill Corp. v. North Dakota* [*Quill*], 1992) ruled that this constitutional requirement prohibited a state from requiring a seller to collect and remit SU tax on sales made to residents of the state unless the seller had a physical presence in the state, such as a business location (e.g., a retail outlet or a warehouse) or employees. Under this rule, if a seller's (e.g., an Internet retailer's) only connection with a state was that it shipped its products to purchasers in the state using a common carrier (e.g., FedEx or the USPS), then that seller was not required to collect SU tax from those purchasers.

If the seller did not charge sales tax on a taxable transaction, then the purchaser very often is obligated to pay use tax on the product he or she purchased. But, in reality, that obligation is often ignored, especially by consumers purchasing products from retailers over the Internet, and it is impractical for states to enforce compliance against individual consumers.

### South Dakota Law (SB No. 106) (the "Act")

In 2016, South Dakota passed the Act as a vehicle to challenge the *Quill* physical presence rule. The Act applies to any seller that does not have a physical presence in South Dakota (a "remote seller") if the remote seller (1) has annual gross revenues from sales into South Dakota in excess of \$100,000, or (2) annually has 200 or more separate sales into South Dakota (the "threshold requirements"). Those remote sellers are required to collect and remit SU tax as if they had a physical presence in South Dakota.

The lower courts all held the Act to be unconstitutional under the *Quill* rule.

In *Wayfair*, the Supreme Court overruled *National Bellas Hess* and *Quill*, holding that physical presence in a state is not required for a remote seller to have substantial nexus for SU tax purposes. The Supreme Court found that *Wayfair* and the other remote sellers before the court - each a "large, national" Internet retailer that met the Act's threshold requirements - "clearly" have substantial nexus with South Dakota. The Supreme Court used strong language in its opinion, noting that the physical presence requirement "ha[d] come to serve as a judicially created tax shelter," and that Internet retailers, in marketing to their customers that they could purchase items free from SU tax, had been making a "subtle offer to assist in tax evasion."

After deciding the substantial nexus question, the Supreme Court remanded the case back to the lower courts to determine whether "some other principle" under the Commerce Clause might still invalidate the Act. However, the Supreme Court strongly implied that the Act is constitutional, noting that (1) due to the threshold requirements, it does not apply to remote sellers only doing limited business in South Dakota, (2) it does not impose an obligation to collect and remit SU Tax retroactively, and (3) compliance burdens are lessened since South Dakota has adopted the Streamlined Sales and Use Tax Agreement, which seeks uniformity of SU tax rules among the states.

### Immediate Impact in Florida?

In 1987, the Florida Legislature passed the Fairness in Retail Sales Taxation Act, adopting Florida Statutes Section 212.0596. While the Florida statute was passed prior to the advent of Internet retail sales, in passing the law the Florida Legislature articulated many of the same reasons that the South Dakota Legislature articulated in passing the Act.

Section 212.0596 governs "mail order sales", which includes a sale of tangible personal property ordered over the Internet from a remote seller that is delivered to a consumer in Florida, and provides that the remote seller is required to collect and remit Florida sales tax if the seller has a "sufficient connection with or relationship to [Florida] or its residents **of some type ... to create nexus** empowering [Florida] to tax its mail order sales or to require the [seller] to collect sales tax or accrue use tax." (emphasis added).

This provision creates SU tax nexus in Florida to the greatest extent permitted by the U.S. Constitution. As noted in briefs filed with the Supreme Court in the *Wayfair* case, the Florida statute (and similar statutes in other states) (1) will automatically cause

the nexus rules in those states to conform to the constitutional standard established in *Wayfair* (see Brief of Tax Executives Institute, Inc. as Amicus Curiae in Support of Respondents, at page 8-9), and (2) would arguably be a basis for retroactive liability against retailers that did not pay sales tax in reliance on *Quill* (see Respondent's Brief in Opposition to Petition for Certiorari, at page 62-65).

Therefore, there appears to be no need for further action by the Florida Legislature in order for the Florida Department of Revenue to begin requiring remote sellers without a physical presence in Florida to begin collecting and remitting Florida sales tax in accordance with Section 212.0596. Significant open questions remain, however, including:

- What level of sales activity into Florida will create substantial nexus for a remote seller in Florida? It is possible that many states will simply adopt South Dakota's thresholds approved by the Supreme Court in *Wayfair*.
- Whether the Florida DOR will assert retroactive liability to any extent, on the basis of Section 212.0596? If so, would it be constitutional?
- Will it matter for the constitutional analysis whether or not a state has adopted the Streamlined Sales and Use Tax Agreement? Florida has yet to adopt that framework.
- Will the *Wayfair* decision finally prompt Congress to create a national standard for SU tax nexus? The dissenting Justices in *Wayfair* agreed with the majority that the *Quill* rule was incorrect, yet argued that it was up to Congress - not the Supreme Court - to alter the rules since the physical presence rule has been in effect since 1967. The majority Justices agreed that Congress may legislate to address this issue.

Any business that sells products or services subject to SU tax should review its tax reporting procedures in light of *Wayfair* in each state that it has customers. If you are considering a M&A transaction, you should note that SU tax compliance has become a high priority diligence item for buyers, as states have increasingly focused on SU tax nexus for out-of-state businesses and the economic exposure for non-compliance can be substantial. The *Wayfair* decision can only be expected to increase that focus.

Hill Ward Henderson will continue to monitor developments in this area. If you have any questions about how the *Wayfair* decision may affect your business or your future plans, please contact us.



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