Yogi on *Wayfair*: It Ain't Over . . .

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In this viewpoint, the authors argue that while the U.S. Supreme Court may have come down on the side of states in *Wayfair*, the full legal ramifications of the decision are not yet known.

"It ain't over till it's over."

Yogi Berra's classic observation still holds up — both in baseball and concerning the U.S. Supreme Court's final order in *South Dakota v. Wayfair*,[1] which was remanded in June to the South Dakota Supreme Court. Before the final order could be submitted and the *Wayfair* decision became the law of the land (the "what"), the South Dakota court had to review and determine whether the state's economic nexus threshold provision meets constitutional requirements (the "how") according to the U.S. Supreme Court's ruling. *Wayfair* set aside the physical presence test for remote sales tax nexus.

The remand has been largely overshadowed by the actions of many states creating, enacting, and enforcing new sales and use tax rules following the *Wayfair* decision as well as by other state-related complicating factors. Regardless of how or when the South Dakota court addressed the remand, tax functions within companies are affected by *Wayfair* and should be aware of the remand, as well as the finer details comprising the settlement, which have not been made entirely public. Tax departments should be aware of and understand their options for responding to the many new post-*Wayfair* state sales tax rules that took effect following the decision; consult with their outside auditing and legal experts; and have the necessary knowledge, processes, and technology in place to comply with the changes.

States Running With New Rules

In 2016 the *Wayfair* decision was set in motion when South Dakota passed a law requiring remote sellers to register, collect, and remit sales tax if they have:

- more than $100,000 of annual gross revenue from the sale of tangible property, electronic products, or services delivered into South Dakota; or
- 200 or more separate transactions per year in which there is a sale of tangible property, electronic products, or services delivered into South Dakota.

[1] *South Dakota v. Wayfair Inc.*, 585 U.S. ___ (2018).

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On June 21 the Supreme Court ruled in favor of South Dakota in *Wayfair*, overturning *Quill*,[2] its 1992 decision that reaffirmed the physical presence nexus requirement. The Court believed that the thresholds in the 2016 South Dakota law help protect smaller businesses from undue burdens on interstate commerce. States that do not already have similar thresholds in place will need to determine how to apply the new nexus standard to prevent smaller businesses from potentially bearing the heaviest economic and administrative burden under the ruling.

However, as part of *Wayfair*, the Supreme Court also remanded the case back to the South Dakota courts to reevaluate whether the new economic nexus presence standard (determined by the aforementioned thresholds) meets a four-part test of constitutionality under the commerce clause. The test was established in a 1977 Supreme Court case, *Complete Auto Transit v. Brady*,[3] and is designed to evaluate substantial nexus, fair apportionment, nondiscrimination (against interstate commerce), and a fair relationship to the services provided by the state. South Dakota and the *Wayfair* litigants reached a settlement in October, the details of which have not yet been disclosed.

This reevaluation, despite the settlement agreement, will continue to the lower courts in South Dakota. Therefore, until this work is complete and the Supreme Court's final order in *Wayfair* is applied and given effect as South Dakota law, states should be cautious about creating their threshold framework for applying the new economic nexus standards in their jurisdictions, as the Court did not specifically endorse the level of activity needed to satisfy constitutional arguments. The terms of the settlement, which requires the defendants to "collect and remit sales tax and follow all applicable procedures and requirements" of S.B. 106[4] (the 2016 South Dakota legislation now codified at S.D. Codified Laws Chapter 10-64), merely makes way for the implementation of the state's economic nexus thresholds. It is now up to the other states to define their own economic nexus guidelines. Despite the loosely endorsed South Dakota example that the Court cited in its ruling, there is no clear, bright-line test or model to guide state policymakers. This was perhaps the Supreme Court majority's intention, since it was their view that only the states themselves are in the best position to frame rules around their budgetary and economic needs.

However, that has not stopped approximately 20 states from going live with new sales tax laws or regulations since the decision, with many more likely to come.

On the other hand, the most populous states — California, Texas, Florida, and New York — have been more cautious and slower to put post-*Wayfair* rules in place even though economic presence stipulations would significantly enlarge their sales tax coffers. Given the potential litigation these states could face if it is later determined that they jumped the gun on instituting and enforcing new sales tax rules, these states likely want to ensure all *Wayfair* legal matters are finalized and well understood before proceeding.

Complicating Factors

The U.S. Supreme Court's remand, as well as the settlement in South Dakota, are not the only factors making post-*Wayfair* sales tax compliance difficult for online sellers. Major practical questions await answers, such as how home-rule states like Colorado, Louisiana, and others can reconcile different economic presence thresholds within the unique sales tax rules that numerous local jurisdictions could potentially enact. Likewise, the Supreme Court was silent on more intricate — but important — constitutional questions, such as the applicability of any specific state sales tax treatment of inbound, foreign remote sellers. It's unclear whether the foreign commerce clause applies to inbound transactions.

Additional complicating factors that could intensify sales tax compliance challenges include:

- **Economic realities:** Many states are contending with significant revenue shortfalls, some of which likely will be exacerbated by the Tax Cuts and Jobs Act (P.L.

[2] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[3] *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274, 288 (1977).

[4] Settlement Agreement, *South Dakota v. Wayfair Inc.*, 32 Civ. 16-92, (S.D. Sixth Jud. Cir. Oct. 31, 2018).

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115-97). These budgeting challenges are motivating more state legislatures to introduce and begin enforcing new sales tax rules quickly and possibly prematurely.

- **Legal challenges:** The specific economic thresholds identified in new sales tax laws could expose individual states to litigation from taxpayers if those thresholds are deemed too low compared with South Dakota's thresholds. How and when the remand is addressed could result in legal challenges to new state sales tax laws enacted since the decision and those scheduled to go live in the coming months.
- **Congressional involvement:** Since *Quill*, Congress has intermittently attempted — but always failed — to pass federal remote sales tax collection legislation. While that may seem to make a new federal bill unlikely, it is important to keep in mind that *Wayfair* could finally provide the spark Congress needs to pass legislation. Since the June decision, Congress has put forth three proposed bills concerning *Wayfair*. Two House bills are designed to limit the negative impacts of states' post-*Wayfair* sales and use tax changes. Another more sweeping proposal, introduced by Sen. Jon Tester, D-Mont., would prevent states from requiring remote sellers to collect and remit sales tax on electronic transactions by essentially reversing *Wayfair*. It seems clear that such a proposal has been contemplated by the *Wayfair* Settlement Agreement and Stipulation, which states that:

> Defendants further specifically agree that collection will begin on January 1, 2019, and continue thereafter in accordance with any valid and applicable law that is consistent with the Supreme Court's decision in *Wayfair*, or any subsequently controlling law, including acts of Congress, that requires any seller of tangible personal property, products transferred electronically, or services for delivery into South Dakota, who does not have a physical presence in the state, to collect and remit sales tax . . . .[5]

[5] *Id.*

Get Informed, Be Ready

The fate of those bills, like most aspects of post-*Wayfair* sales tax compliance, remains uncertain while each state determines how to implement the decision. All of these unknowns leave sales tax professionals in a tough spot.

Ignoring new sales tax collection and remittance requirements exposes companies to significant compliance and audit risks. Companies should first assess the existing economic and business activity exposures, as well as the minimal contact with each state where they conduct business. They should also consider whether any accepted legal or taxability exemptions may apply. Yet adhering to these new rules can subject companies to the muddled and expensive process of refunding customers. So what should tax departments do? It helps to understand the options when determining if and how to comply, which include:

- fully complying by beginning to collect and remit sales tax on the effective date, when applicable;
- not complying until the states where they do business have also reviewed and resolved the Supreme Court issues and communicate their intentions regarding *Wayfair*;
- not complying, but working with the state to reach a better agreement; and
- not complying, but posting reserves to be safe.

Each of these options comes with unique and, in some cases, significant risks. Imagine how a CFO would respond to the notion of posting reserves.

To limit these risks while identifying the optimal compliance approach, it is crucial to consider the following actions:

1. **Be aware:** Recognize that the remand and settlement will have implications on how post-*Wayfair* sales tax rules are written when they take effect and how they are enforced. Also, monitor legislative challenges to new federal and state tax rules, as well as any new sales tax bills at the federal level that emerge or advance.
2. **Consult with outside experts:** External auditing firms should be consulted to determine if they have a legal position on

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a client's sales tax compliance requirements. Companies with outside legal firms should also seek guidance from those experts.

3. **Be ready:** Monitoring state-specific sales and use tax compliance requirements necessitates substantial time and expertise. Tax functions in companies that have not previously submitted state-level sales tax should quickly ramp up this capability via internal resources or external relationships. From a process and supporting technology perspective, the following actions are also useful:
   - gather data on gross revenues and the number of transactions that occur within states where the company sells remotely;
   - prioritize states where the company has the greatest economic presence and create a plan to register to collect and remit sales tax (for example, via a marketplace — or with a hosted or cloud-based technology solution);
   - evaluate the financial statement impact of remote seller compliance; and
   - review invoicing processes and controls to ensure that a correct invoice is produced by a seller and received by the customer. Sales tax calculation on an invoice is a critical business process and if not done correctly, can become both a customer satisfaction and cash flow issue.

Above all, tax executives and their teams should stay on their toes, regardless of how the remand plays out. As Yogi Berra also observed, "It's tough to make predictions, especially about the future." So, it is wise to be prepared for more than one possible outcome — especially when it comes to *Wayfair*'s still unfolding and long-lasting implications. ■

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