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TAX ALERT – JULY 11, 2018

U.S. Supreme Court Adopts Economic Presence Standard in Landmark State Sales Tax Case

On June 21, 2018, the U.S. Supreme Court handed down its decision in *South Dakota v. Wayfair*. The Court ruled that an out-of-state retailer is not required under the Commerce Clause of the U.S. Constitution to have physical presence in a state in order for that state to impose a requirement to collect its sales tax. Economic presence may now satisfy the Commerce Clause requirement of “substantial nexus” between a state and an out-of-state retailer.

As a result of the Court’s decision in *Wayfair*, the economic presence nexus (*i.e.*, a certain level of economic activity in a state, in South Dakota’s case \$100,000 of sales or 200 transactions) becomes a viable threshold for creating nexus under the Commerce Clause. The case is a victory for state tax coffers, as well as for local businesses that had been complaining over what they saw as an unfair advantage for remote vendors.

Prior to June 21, 2018 the standard under the Commerce Clause for whether a state could require an out-of-state retailer to collect and remit sales tax has been physical presence as set forth in the Court’s decisions in *National Bellas Hess* in 1967 and *Quill* in 1992. In *Wayfair* the Court considered the constitutionality of South Dakota’s application of its sales tax to internet retailers who sell into South Dakota but have no property or employees in the state. South Dakota’s laws require a business to collect and pay South Dakota sales tax if the business has annual sales above \$100,000 or completes 200 or more sales transactions with South Dakota residents, regardless of whether the business had a physical presence in the State.

The Court in *Wayfair* decided in favor of South Dakota and expressly overruled the Court’s decisions in *National Bellas Hess* and *Quill*. According to the Court’s opinion in *Wayfair*, the physical presence rule is “artificial in its entirety”; emphasis should be on marketplace dynamics, not “anachronistic formalisms.” The Court specifically observed that South Dakota’s tax laws minimize the burden on interstate commerce. South Dakota is a member of the Streamlined Sales and Use Tax Agreement, which reduces the burden of compliance for taxpayers and even provides state-funded sales tax administration software.



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South Dakota's new economic nexus standard specifically provides that it is not retroactive and is effective on June 21, 2018, at the earliest. However, other states with similar economic nexus rules have not expressly provided that their economic nexus laws are not retroactive.

In light of *Wayfair*, businesses should expect states to quickly apply and craft their statutes to provide for economic presence nexus standards similar to those blessed by the Supreme Court with respect to South Dakota law. In recent years, a growing number of states already enacted economic nexus laws similar to South Dakota that openly disregard the physical presence requirement by asserting nexus based on the number and/or dollar amount of sales into the state.

Action Steps for Your Business

Performing or updating a state nexus analysis is one of the first steps your business should consider. Some preliminary questions include:

- Into which states do you sell products and services?
- What is the dollar value of sales into each state and the number of transactions?
- What type of products and services do you sell?
- What is the type (*e.g.* retailers, end-users, manufacturers, contractors, etc.) of your customers in each state?
- Do you have sales in “click-through” nexus states (*i.e.*, states where an in-state online business refers customers through links to buy something from the out-of-state online business)?
- If you are part of an affiliated group, do you have sales in “affiliate” nexus states?
- Should you adopt a sales tax collection system for all applicable states and avoid having to comply with the additional notification requirements to your customers and local governments imposed by a number of states?

Keep in mind that the existing physical presence and other nexus standards remain intact after *Wayfair*. Therefore, you should continue to keep track of any property, employees, agents, or other physical presence you have in any given state.

With thousands of distinct sales and use tax rates imposed nationwide, and with the changing nexus definitions, businesses will require professional assistance to navigate the murky waters of multistate sales and use tax compliance obligations.

This content is for general information purposes only, and does not constitute tax advice.

If you have any questions or would like additional information on the topics covered in this alert, please contact your engagement partner.

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